KUWAIT FINANCE HOUSE (MALAYSIA) BERHAD

(672174-T)

(Incorporated in Malaysia)

Directors' Report and Audited Financial Statements as at 31 December 2013

Registered Office:
Level 26, Menara Prestige
No.1, Jalan Pinang
P.O.Box 10103
50450 Kuala Lumpur

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1 PERFORMANCE OVERVIEW

The Group and the Bank registered a profit before tax of RM148.6 million and RM145.2 million respectively for the financial year ended 31 December 2013.

The Group's Total Capital Ratio and CET 1/ Tier 1 Capital Ratio as at 31 December 2013 stood at a commendable 21.78% and 18.01% respectively.

2 STATEMENT OF CORPORATE GOVERNANCE

(i) Board responsibility and oversight

Kuwait Finance House (Malaysia) Berhad (hereinafter referred to as “the Bank”) acknowledges that good corporate governance practices form the cornerstone of an effective and responsible organisation. The Bank continuously pursues its efforts in implementing a corporate governance framework and structure which ensures protection of shareholder's rights as well as recognition of the rights of all other stakeholders ranging from customers, creditors, suppliers, employees, regulators and the community.

Roles and Responsibilities of the Board

As a custodian of corporate governance, the Board provides strategic direction and effective control of the Bank with a view to preserve the Bank's long term viability whereby the Board reviews and evaluates the strategic planning process and monitors the implementation of the strategy carried out by the management.

In safeguarding the Bank's assets, shareholder's investment and stakeholders' interests, the Board also ensures that the Bank is equipped with an effective system of internal controls, and that there is a satisfactory framework of reporting on internal financial controls and regulatory compliance, as well as an effective risk management system, which effectively monitors and manages the principal risks of the business.

Accountability is part and parcel of governance in the Bank as whilst the Board is accountable to the shareholder, the management is accountable to the Board. The Board ensures that the management acts in the best interests of the Bank and its shareholder, by working to enhance the Bank's performance.

The Board oversees the conduct of the Bank's businesses by ensuring that the business is properly managed by a management team of the highest calibre.

2 STATEMENT OF CORPORATE GOVERNANCE (Cont'd.)

(i) Board responsibility and oversight (Cont'd.)

There is a clear division of responsibility between the Board and the management. The Chief Executive Officer is supported by a team of senior management who are responsible for the implementation of Board resolutions, overall responsibilities of the day-to-day operations of the Bank's business and operational efficiency.

Board Balance

The Board currently has seven (7) members, comprising four (4) independent non-executive directors, three (3) non-independent non-executive directors.

Directors' Profile

Dr. Nabeel A E A Al-Mannae
Chairman
Independent non-executive director

(54 years of age – Kuwaiti) PhD. in Economics from the University of Miami (1987), Florida, Masters of Arts (Economics) from Florida International University (1983) and a Degree in Commerce (Economics) from the Kuwait University.

Dr. Nabeel had served at the Central Bank of Kuwait in a career that spanned 21 years from 1987 to 2008, held numerous key positions including as the Deputy Governor for a period of 10 years.

He had also been the Board Member for various corporations in Kuwait and Member of various national and international specialized committees. He joined Kuwait Finance House as Vice Chairman on 14 March 2011.

He was appointed as Director and Chairman of the Bank on 5 September 2011.

Shaheen H A KH SH Alghanem
Deputy Chairman
Non-independent non-executive director

(46 years of age - Kuwaiti) Master of Business Administration, General Management Program, Certified Management Accountants, Bachelor of Commercial in Accountancy.

Mr. Shaheen was with Kuwait National Petroleum Company (Oil Refinery) and International Investor in the State of Kuwait before joining Kuwait Finance House, as Manager in the Financial Control Department. He is now a General Manager, International Banking of Kuwait Finance House.

He was appointed as Director of the Bank on 18 March 2007 and was the Chairman of the Bank from 6 August 2007 until 5 September 2011. He was redesignated as the Deputy Chairman of the Bank since 5 September 2011 to be in line with the requirements of BNM GP1-i.

2 STATEMENT OF CORPORATE GOVERNANCE (Cont'd.)

(i) Board responsibility and oversight (Cont'd.)

Gopala Krishnan A/L K Sundaram
Member
Independent non-executive director

(59 years of age - Malaysian) Bachelor of Law L.L.B. (Hons.) (Mal) from Universiti Malaya, Kuala Lumpur.

Mr Gopala has served Bank Negara Malaysia for 30 years as a Project Advisor and Assistant Governor as well as held various senior positions in the Central Bank's Legal Department. During his tenure with BNM, he was extensively involved with legislative drafting, financial crises management, resolution of ailing financial institution and international technical assistance, among others.

He was appointed as Director of the Bank on 11 June 2012.

Khalid Sufat
Member
Independent non-executive director

(58 years of age - Malaysian) Malaysian Institute of Certified Public Accountants ("MICPA"), Chartered Association of Certified Accountants (UK).

En Khalid was appointed to the Board of the Bank on 3 January 2011. He is an Accountant by profession and a member of the Malaysian Institute of Accountants (MIA). He is also a Fellow of the Chartered Association of Certified Accountants, UK and also a member of the MICPA.

He had considerable experience in the banking industry having held several senior positions, namely Managing Director of Bank Kerjasama Rakyat Malaysia Berhad, General Manager, Consumer Banking of Malayan Banking Berhad and Executive Director of United Merchant Finance Berhad.

He had previously managed three listed companies, namely as Executive Director of Tronoh Mines Malaysia Berhad, as Deputy Executive Chairman of Furqan Business Organisation Berhad and as Group Managing Director of Seacera Tiles Berhad.

His directorships in other public listed companies include UMW Holdings Berhad and Chemical Company of Malaysia Berhad.

Dr Paul Quigley
Member
Non-independent non-executive director

(56 years of age - Irish) PhD. in Finance from University of Birmingham, United Kingdom.

Dr Quigley joined Kuwait Finance House, Kuwait as Chief Risk Officer in July 2011. Prior to that, he was the Chief Executive Officer of the Institute of Bankers in Ireland. He had also served as the General Manager, Risk Management and Architecture at AIB Group.

He was appointed as Director of the Bank on 13 December 2012.

2 STATEMENT OF CORPORATE GOVERNANCE (Cont'd.)

(i) Board responsibility and oversight (Cont'd.)

Mohamed Zaheer Mohamed Azreen
Member
Non-independent non-executive director

(44 years of age – Sri Lankan) Chartered Institute of Management Accountants (CIMA) UK, Institute of Chartered Accountants (ICASL) of Sri Lanka, Institute of Certified Management Accountants (ICMA) of Sri Lanka, Certified Risk Analyst (CRA) US.

Mr Azreen was appointed to the Board of the Bank on 10 April 2011. He is an Associate Member of CIMA UK, an Associate Member of ICASL of Sri Lanka, a Fellow Member of ICMA of Sri Lanka and Charter holder of CRA.

Mr Azreen started his career as article clerk and then promoted as Manager Audit and Consultancy at KPMG Ford Rhodes Thornton & Co in Colombo, Sri Lanka in 1991. He then joined Messrs Ernst & Young (EY), Bahrain Office in October 1996 as the Senior Accountant and was assigned the responsibilities of managing business community training unit which provide in house training to EY employees and its clients on various accounting and finance disciplines. He then joined Kuwait Finance House, Kuwait (KFHK) in 1999 as Investment Manager, Direct Investment Department. He is currently the Senior Investment Manager, Direct Investment Department whereby he is responsible in managing a portfolio in excess of USD2billion distributed in different sectors and geographies.

Md Adnan Md Zain
Member
Independent non-executive director

(57 years of age – Malaysian) Bachelor of Economics from Universiti Putra Malaysia and Registered Financial Planner certified by the Malaysian Financial Planning Council.

En Md Adnan's career has been in the banking and insurance industries both foreign and local. He started his career with Standard Chartered Bank in 1981 and moved on to various senior positions in Amanah Finance Malaysia Berhad, Alliance Merchant Bank Bhd, RHB Bank Berhad and eventually was appointed as the CEO of MCIS Zurich Insurance Berhad before he retired.

He was appointed as Director of the Bank on 15 January 2014.

2 STATEMENT OF CORPORATE GOVERNANCE (Cont'd.)

(i) Board responsibility and oversight (Cont'd.)

Board Meetings

During the financial year ended 31 December 2013, thirteen (13) Board meetings were held and attended by the directors. In the said Board meetings, reports on the progress of the Bank's business operations, budgets, evaluation of business propositions and corporate proposals and other matters were tabled for deliberation, approval, endorsement and reviewed by members of the Board.

The agenda for every Board meeting together with management reports, proposals and supporting documents were circulated to all directors in advance prior to the scheduled Board meetings for their perusal.

Minutes of every Board meeting were also circulated to all directors for their perusal prior to confirmation of the minutes at the following Board meeting.

Board Committees

The Board is assisted by seven (7) Board Committees with specific terms of reference and functions, as follows:

Board Audit Committee

The Board Audit Committee ("BAC") consists of two (2) independent non-executive directors and one (1) non-independent non-executive director. Ten (10) BAC meetings were held during the financial year. The members are as follows:

Khalid Sufat - Chairman
Mohamed Zaheer Mohamed Azreen - Member
Gopala Krishnan A/L K Sundaram - Member
Shaheen H A KH SH Alghanem - Member (Resigned on 1 February 2013)
Dato' Sri Abdul Hamidy Abdul Hafiz - Member (Resigned on 20 March 2013)

2 STATEMENT OF CORPORATE GOVERNANCE (Cont'd.)

(i) Board responsibility and oversight (Cont'd.)

Board Audit Committee (Cont'd.)

The roles and responsibilities of the BAC are to assist the Board in discharging its oversight duties and oversee the financial reporting process to ensure the balance, transparency and integrity of its published financial information. The BAC also reviews the effectiveness of the Bank's internal financial controls and risk management system, the internal audit function, the independent audit process including the appointment and assessing the performance of the external auditor, the process for monitoring compliance with laws and regulations affecting financial reporting and its code of business conduct.

Board Risk Management Committee

The Board Risk Management Committee (BRMC) consists of one (1) independent non-executive director and two (2) non-independent non-executive directors. Eight (8) BRMC meetings were held during the financial year. The members are as follows:

Gopala Krishnan A/L K Sundaram - Chairman (Re-designated as Chairman on 21 March 2013)
Mohamed Zaheer Mohamed Azreen - Member
Dr Paul Quigley - Member (Appointed on 1 February 2013)
Khalid Sufat - Member (Resigned on 1 February 2013)
Dato' Sri Abdul Hamidy Abdul Hafiz - Member (Resigned on 20 March 2013)

The roles and responsibilities of the BRMC are to oversee the Bank's activities in managing credit, market, operational and other risks and to ensure that the risk management framework and processes are robust and functions effectively. The BRMC also oversees the formulation of risk strategies on an on-going basis and addresses issues arising from the changes in both the external business environment and internal operating conditions. The Risk Management function is overseen by the Chief Risk Officer, who reports to BRMC.

In addition, the BRMC assists the Board in ensuring the effectiveness of the Bank's daily operations so that the Bank's operations are in accordance with the corporate objectives and risk strategies as well as the approved risk policies.

2 STATEMENT OF CORPORATE GOVERNANCE (Cont'd.)

(i) Board responsibility and oversight (Cont'd.)

Nominating Committee

The Nominating Committee ("NC") consists of two (2) independent non-executive directors and two (2) non-independent non-executive directors. Four (4) NC meetings were held during the financial year. The members are as follows:

Dr. Nabeel A E A Al-Mannae - Chairman
Shaheen H A KH SH Alghanem - Member
Khalid Sufat - Member
Dr Paul Quigley - Member (Appointed on 21 March 2013)
Dato' Sri Abdul Hamidy Abdul Hafiz - Member (Resigned on 20 March 2013)
Abdul Wahab I.A.A. AlRushood - Member (Expiry of term of office on 28 August 2013)

The roles and responsibilities of the NC are to provide a formal and transparent procedure for the appointment of directors, Chief Executive Officer and key senior management personal, as well as assessment of the effectiveness of individual directors, the Board as a whole and the performance of the Chief Executive Officer and key senior management personnel.

Board Transformation Sub-Committee

The Board Transformation Sub-Committee ("BTSC") consists of one (1) non-independent non executive director and two (2) independent non-executive directors. Eight (8) BTSC meetings were held during the financial year. The members are as follows:

Mohamed Zaheer Mohamed Azreen - Chairman
Khalid Sufat - Member
Gopala Krishnan A/L K Sundaram - Member

The roles and responsibilities of the BTSC are to provide independent oversight for the implementation of the Bank's transformation plan as a whole.

2 STATEMENT OF CORPORATE GOVERNANCE (Cont'd.)

(i) Board responsibility and oversight (Cont'd.)

Remuneration Committee

The Remuneration Committee ("RC") consists of two (2) independent non-executive directors and one (1) non-independent non-executive director. Six (6) RC meetings were held during the financial year. The members are as follows:

Dr. Nabeel A E A Al-Mannae - Chairman
Gopala Krishnan A/L K Sundaram - Member
Dr Paul Quigley - Member (Appointed on 1 February 2013)
Mohamed Zaheer Mohamed Azreen- Member (Resigned on 1 February 2013)
Abdul Wahab I.A.A. AlRushood - Member (Expiry of term of office on 28 August 2013)

The roles and responsibilities of the RC are to provide a formal and transparent procedure for developing remuneration policy for directors, Chief Executive Officer and key management personnel as well as to ensure that the Bank's compensation packages are competitive and consistent with the Bank's culture, objectives and strategies.

Board Credit & Investment Committee

The Board Credit & Investment Committee ("BCIC") consists of two (2) non-independent non-executive directors and one (1) independent non-executive director. Seventeen (17) BCIC meetings were held during the financial year. The members are as follows:

Shaheen H A KH SH Alghanem - Chairman
Mohamed Zaheer Mohamed Azreen - Member
Gopala Krishnan A/L K Sundaram - Member (Appointed on 23 January 2013)
Dato' Sri Abdul Hamidy Abdul Hafiz - Member (Resigned on 20 March 2012)
Abdul Wahab I.A.A. AlRushood - Member (Expiry of term of office on 28 August 2013)

The roles and responsibilities of the BCIC are primarily to oversee the approval of credit and Treasury's investment proposals, reviews, restructuring, collections and recovery matters, and other operational and administrative requests that exceeds the authority delegated to the Management Credit, Investment and Recovery Committee.

2 STATEMENT OF CORPORATE GOVERNANCE (Cont'd.)

(i) Board responsibility and oversight (Cont'd.)

Board Recovery Committee

The Board Recovery Committee ("BRC") consists of two (2) non-independent non executive directors and one (1) independent non-executive director. Nine (9) BRC meetings were held during the financial year. The members are as follows:

Shaheen H A KH SH Alghanem - Chairman (Appointed as member on 1 February 2013 and re-designated as Chairman on 21 March 2013)
Gopala Krishnan A/L K Sundaram - Member
Mohamed Zaheer Mohamed Azreen - Member
Dato' Sri Abdul Hamidy Abdul Hafiz - (Resigned on 20 March 2013)

The main objectives of the BRC are to optimize collections and recovery actions with a view to maximize returns to the Bank, to protect the Bank's interest and reputation and to provide guidance and direction to the Special Asset Management team.

(ii) Internal audit and internal control activities

The Board is responsible for the Bank's system of internal controls and its effectiveness. Such a system is designed to manage the Bank's risks within an acceptable risk level and profile, rather than to eliminate all risk of failure, as well as to achieve the policies and business objectives of the Bank. Accordingly, it provides reasonable assurance and not absolute assurance against material misstatement of management and financial information and records or against financial losses or fraud.

Internal controls

The key processes below have been established in reviewing the adequacy and integrity of the system of internal controls.

The Internal Audit Division examines the Bank and its subsidiaries for compliance with policies, procedures, applicable law, rules and regulations and assesses the effectiveness of the internal control systems, highlighting findings that carry significant financial and non-financial impact to the Bank. Status of implementation of action plans to address the findings are closely monitored and reported to the Board Audit Committee ("BAC"). The annual audit plan, prioritised based on risks associated with key business processes is reviewed and approved by the BAC.

The Internal Audit Division is also responsible for the identification of internal control and corporate governance issues, in addition to the findings by the external auditors, regulatory authorities and management as well as evaluating the adequacy and effectiveness of the Bank's risk management and internal control systems. The Internal Audit Division is monitored by the BAC with particular emphasis on the scope of audits, quality of internal audits, audit implementation and independence of the Internal Audit Division of the Bank.

2 STATEMENT OF CORPORATE GOVERNANCE (Cont'd.)

(ii) Internal audit and internal control activities (Cont'd.)

Internal controls (Cont'd.)

Management committees that have been established include the Management Committee ("MANCO"), Operations Committee ("OPSCO"), Management Credit, Investment & Recovery Committee ("MCIRC"), Asset Liability Management Committee ("ALCO"), Information Technology Steering Committee ("ITSC"), Tender Committee and Provision Review Committee.

The effectiveness of the Bank's daily operations is monitored and reviewed by the Board Risk Management Committee ("BRMC") so that the Bank’s operations are in accordance with the corporate objectives, strategies, annual budget as well as approved policies and business directions.

An on-going process of identifying, evaluating and managing the significant risks faced by the Bank is monitored by the BRMC, which includes updating the system of internal controls when there are changes to the business environment or regulatory guidelines. The process is also regularly reviewed by the Board in order to comply with the regulatory guidelines for directors on internal control, Islamic financial institutions and the Statement on Internal Control.

Management reports

Management reports are presented to and reviewed by the Board on a regular basis. In addition to the financial statements, other reports tabled before the Board at periodical meetings include the reports on monitoring of compliance with banking laws and other Bank Negara Malaysia's guidelines on financing, capital adequacy and other regulatory requirements, as well as monthly progress reports on business operations.

The annual business plan and budgets that are prepared by the Bank's business units are also reviewed and approved by the Board.

The Bank has also put in place policies, guidelines and authority limits imposed on Executive/ Managing Director and management within the Bank in respect of the day-to-day banking and financing operations, extension of credits, investments, acquisitions and disposal of assets.

In addition, proper policies and guidelines are in place within the Bank in relation to hiring and termination of employees, formal training programmes for employees, annual/ semi-annual performance appraisals and other relevant procedures to ensure the employees are competent and adequately trained in carrying out their responsibilities.

2 STATEMENT OF CORPORATE GOVERNANCE (Cont'd.)

(iii) Risk Management

Audited information according to MFRS 7 and MFRS 101

Risk management disclosures provided in line with the requirements of the Malaysian Financial Reporting Standard ("MFRS") 7 *Financial Instruments: Disclosures* , and disclosures on capital management as required by MFRS 101 *Presentation of Financial Statements (Revised)* form part of the financial statements audited by the Bank's independent auditors Ernst & Young. This information (the audited texts and tables) is marked by a bar on the left-hand side throughout this report and incorporated by cross-reference into the financial statements of this report.

<u>Highlights of major achievements</u>

The Bank has been taking proactive measures to manage various risks posed by the rapidly changing business environment. These risks, which include credit risk, market risk, liquidity risk, reputational risk, business risk, strategic risk and operational risk, are systematically managed within the Bank’s risk governance, infrastructure and tools.

During the year under review, the Bank has successfully implemented and/or developed few major initiatives to address the above risks. The major achievements of the Bank include:

- The Bank has completed its first Internal Capital Adequacy Assessment Process (“ICAAP”) approved by the Board and submitted to BNM in March 2013;
- The Bank has commenced the ‘Capital Appropriation and Preservation’ initiative mainly to operationalise capital optimisation strategies as required by ICAAP;
- The Bank has formally established ‘Second Level Key Risk Appetite Monitoring’ mechanism through the identified Key Risk Indicators (“KRIs”) reported to the Management on a periodical basis;
- The Bank has adopted the calculation of Basel III liquidity ratios i.e. liquidity coverage ratio, net stable funding requirement and leverage ratio;
- The Bank has applied PV01 as a measurement tool for profit rate risk for all sukuk portfolios and foreign exchange Net Open Position limit to mitigate potential loss arising from market risk;

2 STATEMENT OF CORPORATE GOVERNANCE (Cont'd.)

(iii) Risk Management (Cont'd.)

Highlights of major achievements (Cont'd.)

- The Bank has produced more granular portfolio reports for BRMC and management for decision making process via the usage of a business intelligence tool;
- The Bank has further refined the credit risk exposure limits set at portfolio level for better effectiveness in monitoring as well as to align with changes in business environment;
- The Bank continues to pro-actively review its credit policies and guidelines to effectively address various risks inherent in the Bank’s business activities;
- The approval power and authority matrix of relevant board and management level committees have been revised for better efficiency and effectiveness in terms of business processes;
- The Bank has further refined the anti-money laundering system to be more efficient in detecting and capturing potential money laundering activities as well as in conducting periodic screening on existing customers against entities suspected involved in terrorism as issued by United Nations Security Council (“UNSC”); and
- The Bank has implemented the e-learning platform to ensure the staff’s continued awareness on AMLCFT matters.

Moving on FY2014

The Bank has embarked on long term risk management enhancement initiatives with the objective, among others, to build for the Bank a robust risk management infrastructure with capabilities that commensurate with the business sophistication and later for new business areas.

Risk Management Framework

The Board has delegated the overall responsibility of reviewing the effectiveness of risk management practices to the Board Risk Management Committee (“BRMC”). Generally, BRMC assists the Board in reviewing and overseeing the effectiveness of the risk management practices of the Bank whilst Risk Management Division facilitates in institutionalising continuous monitoring and evaluation of the Bank’s risk management practices. Any risk management policy and framework formulated to identify, measure, and monitor various risk components would be reviewed and recommended by the BRMC to the Board for its approval. BRMC also reviews and assesses the adequacy of these risks management policies as well as ensures sufficient infrastructure, resources and systems are in place for better risk management. The risk management principles, policies, procedures and practices are updated regularly to ensure relevance and compliance with current/ applicable laws, regulations, and changes in business environment, and are made available to all employees.

2 STATEMENT OF CORPORATE GOVERNANCE (Cont'd.)

(iii) Risk Management (Cont'd.)

Three Lines of Defence Concept

The Bank adopts the concept of three (3) lines of defence i.e. risk taking units, risk control units and internal audit. The risk taking units are responsible for the day-to-day management of risks assumed by them in their business activities while the risk control units manage the provision of specialised resources for the setting risk management framework and developing appropriate risk management tools and methodologies. Additionally, internal audit complements the concept by providing independent assurance of the effectiveness of the risk management process and approaches implemented by the Bank.

Credit Risk Management

The Bank defines credit risk as the risk of potential loss arising from a customer defaulting on its obligation to the Bank. In 2013, the corporate and commercial financing segment continues to contribute a major share of the Bank's financing and investment assets. In addition, the consumer financing segment has also grown from 20% of the Bank's total financing assets in 2011 to 28% of the Bank's total financing assets in 2012 as a result of the business initiatives and strategies that were implemented to grow the retail and consumer banking segment.

Credit risk limit is further refined whereby exposure limits were set at portfolio level. A Weighted Average Credit Grade ("WACG") and Collateral Management System are implemented to track the quality of the Corporate and Commercial portfolio.

The financing and investment limits are established in accordance to Board approved Credit Delegation Approval Matrix for all types of financing and investment transacted by the Bank which are also monitored by Credit Risk Management and by the Management Credit, Investment and Recovery Committee.

The Credit Management team, consisting of independent full time credit personnel, plays a central role in analysing, reviewing and monitoring transactional credits pertaining to corporate, commercial and consumer financing activities. Counterparty risk is restricted and monitored at the customer level which is in accordance to the BNM/Single Counterparty Exposure Limit (SCEL) which superseded the previous BNM/GP5 definition and internal practice. The Bank has completed the project to enhance the process in place to meet the requirements of the SCEL guidelines.

The Bank's credit risk policies and guidelines set the principles, by which the Bank and its related subsidiaries conduct their credit risk management activities. It ensures credit risk underwriting consistency across the Bank and provides guidance in the formulation of supplementary credit policies and practices specific to business units.

The Credit Risk Management team has made further progress in ensuring that more relevant and granular analysis reports are presented to the BRMC and Management by using the business intelligence tools. The team has also made the business intelligence tools available to the Consumer Banking Department and the Collection Consumer Banking Department. This will allow users to easily make changes and customise different forms of analysis which will be extremely useful for performance monitoring, proactive collection strategies and identification of business credit risks and opportunities.

2 STATEMENT OF CORPORATE GOVERNANCE (Cont'd.)

(iii) Risk Management (Cont'd.)

Market Risk Management

The objective of market risk management is to ensure that all activities which expose the Bank to market risks are properly controlled, managed and monitored.

Market risk is defined as the risk of losses or reduction in values in on- and off-balance sheet positions arising from movements in market prices. Specifically, the following positions may be exposed to market risk:

- Financial instruments (including hedging financial instruments);
- Foreign exchange including gold;
- Inventories; and
- Commodities.

Liquidity Risk Management

Liquidity risk is defined as inability of the Bank to meet cash flow obligations in a timely and cost-effective manner. It arises when the Bank does not have sufficient maturing assets to cover maturing liabilities that are not rolled over. The Bank adopts the BNM's New Liquidity Framework as a foundation in managing its liquidity. The objective of liquidity risk management is to ensure that cash needs can always be met at reasonable cost, either by:

- Maturity or sale of assets; or

- Acquisition of deposits or additional funding from the Islamic money markets.

The Bank has also adopted Basel III's new Liquidity Coverage Ratio and internal 3-days Liquidity Coverage Ratio as a liquidity risk management tool to ensure the next 30 days and 3 days cashflow obligations are sufficient. The Bank has also developed a Contingency Funding Plan to further managed its liquidity risk.

Liquidity risk management function is overseen by Asset and Liability Committee ("ALCO"), which is guided by the Bank's Asset and Liability Management Policy.

2 STATEMENT OF CORPORATE GOVERNANCE (Cont'd.)

(iii) Risk Management (Cont'd.)

Profit Rate (Rate of Return) Risk Management

Profit rate risk refers to movements in profit rates that can expose the Bank to higher funding costs or lower investment and financing yields. Due to the nature of the Bank's business, changes in profit rates can adversely affect the Bank in the form of lower net revenue depending on the mix and form of assets and liabilities.

The profit rate risk management function is overseen by ALCO comprising members of the senior management representing major business units, Finance Division and Risk Management Division.

The primary aim of profit rate risk management is to maintain the Bank's profit rate risk exposure within acceptable parameters when there is a change in the market profit rate. Profit rate risk limits shall provide the means for achieving this objective.

ALCO had set the limits for the following ratios:

• The total of fixed rate financing over the Bank's total financing;

• The 3 months rate sensitive assets over the 3 months rate sensitive liabilities; and

• PV01 measurement.

Operational Risk Management ("ORM")

The Bank has established Operational Risk Management Policy aiming at managing the operational risk throughout the Bank and ensuring alignment with the business strategy. Operational risk is defined as the risk of losses resulting from either inadequate or failed internal processes, people and systems or from external events which includes legal risk, reputational risk and Shariah non-compliance risk but excludes strategic risk.

In order to promote the accountability and ownership of risk management, all the Business and Support Divisions within the Bank are required to identify, document and assess the risks arising from their daily activities using Risk Assessment Self Assessment and Risk Assessment Scorecard which form part of the operational risk management tools and processes. By implementing these assessments, the Bank is able to identify the key risks impacting key processes and areas requiring improvements.

The Bank also implemented risk incident reporting requirement where all the Business and Support Divisions are to report the actual, potential and near misses incidents. This reporting requirement is established to ensure proper escalation and management of such incidents. These incidents reported will be reviewed thoroughly to determine the root cause and subsequently improvement on the control measures to mitigate the recurrence of those risk incidents.

2 STATEMENT OF CORPORATE GOVERNANCE (Cont'd.)

(iii) Risk Management (Cont'd.)

Operational Risk Management (ORM) (Cont'd.)

Shariah Governance Working Group comprising members from Shariah Compliance and Review, Shariah Audit and Shariah Risk Management has been established as a platform to discuss any matters pertaining to shariah risk management process, risk arising from the implementation of shariah requirement and shariah non-compliance issues that may arise from the Bank's activities as well as to ensure clear accountabilities and follow-through action on issues identified. Currently, shariah risk management function resides within operational risk management team.

The delegation of approving power and authority of the Bank's various committees and key personnel are documented properly to ensure clear accountability and responsibility. Changes in the approving power and authority must be reviewed and concurred by Risk Management Division. Various policies and procedures governing the Bank's businesses and operations processes are documented and made available to all employees as references.

Regulatory & Anti-Money Laundering Compliance ("RAC")

Under the Bank's Compliance Policy, the line management plays an important role in cultivating a compliance culture within the organisation. The Bank has appointed Business Unit Compliance Officers ("BUCOs") at divisional / departmental levels who are responsible to identify applicable regulatory requirements at their respective divisions / departments and to keep RAC informed on an ongoing basis of the quality of compliance, compliance deficiencies, gaps in work processes and the status of any corrective actions.

As a fully licensed Islamic Bank, the Bank has a legal obligation to deter money laundering and counter financing of terrorism within the ambit of the Anti-Money Laundering and Anti-Terrorism Financing Act 2001 ("AMLATFA"). As such, the Bank is at the forefront of the Government and BNM's continuous initiatives in the prevention of the use of the banking system at any point for money laundering or terrorist financing activities.

The Bank has demonstrated its full commitment of compliance with the Anti-Money Laundering / Counter Financing of Terrorism ("AML/CFT") requirements by establishing robust and comprehensive framework, policies, procedures, processes and systems for the prevention and detection of money laundering and terrorist financing activities. The Head of Compliance reports directly to the Board Chairman on AML/CFT matters since January 2013. Key measures undertaken by the Bank to mitigate the AML/CFT risks include:

2 STATEMENT OF CORPORATE GOVERNANCE (Cont'd.)

(iii) Risk Management (Cont'd.)

Regulatory & Anti-Money Laundering Compliance ("RAC") (Cont'd.)

- Established Know Your Customer ("KYC") policy and procedures to address the establishment of new business relationship with customers;
- Implemented a dedicated anti-money laundering ("AML") system since 15 July 2008. The system has enabled the Bank to effectively conduct ongoing monitoring on customer transactions through a dedicated Management Information System ("MIS") for prompt detection and reporting of suspicious transactions;
- Constant review of the AML system to optimise detection of potential money laundering activities and incorporate regular screening exercise for entities suspected involved in terrorism as issued by United Nations Security Council ("UNSC");
- Record keeping procedures in accordance with the statutory requirements;
- Conduct regular AML/CFT training sessions to ensure high level of staff awareness on the matters. In 2013, besides conducting classroom training, the Bank has successfully implemented the e-learning platform to further enhance the staff awareness; and
- Regular update to the Management, BRMC and the Bank's Chairman on AMLCFT trend of the Bank.

The AMLCFT measures have undergone thematic assessment by the regulators and further validated internally as part of the ongoing risk assessment towards meeting the revised Financial Action Task Force ("FATAF") recommendations.

The above measures especially with the implementation of a dedicated MIS to systematically conduct ongoing customer due diligence and to monitor the customers' transactions on a daily basis, demonstrate that the Bank including KFH Group have shown strong commitment in ensuring compliance to the relevant AML legislations as well as to protect the Bank's integrity and reputation.

Capital Adequacy Framework Initiatives

The Bank is of the view that it is important to have in place sound practices in managing the range of risks facing the Bank and its potential impacts on the Bank's capital. Hence, the Capital Planning Unit has continued to complement the risk management practices carried out in the Bank. The Unit is also tasked to ensure the successful adoption of Pillar 1, 2 and 3 under BNM Capital Adequacy Framework for Islamic Bank ("CAFIB").

2 STATEMENT OF CORPORATE GOVERNANCE (Cont'd.)

(iii) Risk Management (Cont'd.)

<u>Capital Adequacy Framework Initiatives (Cont'd.)</u>

<u>Pillar 1</u>

Under BNM CAFIB which specifies the risk measurement methodologies to calculate minimum capital requirements to be held by Islamic banks, the Bank has adopted the following approaches:

- Credit Risk Charge – Standardised Approach
- Market Risk Charge – Standardised Approach
- Operational Risk Charge – Basic Indicator Approach

The Bank was in compliance with all regulatory capital ratios prescribed under Pillar 1 throughout the year.

<u>Pillar 2 (Internal Capital Adequacy Assessment Process – ICAAP)</u>

ICAAP document was approved by the Board and submitted to BNM in March 2013. The content of ICAAP document includes overview of ICAAP, current and projected financial and capital position, ICAAP governance, risk assessment models and processes, risk appetite, capital management, stress testing and capital planning. This document is developed to ensure adequate capital is available to support its activities and operations at all times which are in line with BNM guidelines and international best practices.

The Bank has carried out comprehensive assessment of its existing capital and risk management practices against expectations set forth in the BNM Guideline. The Bank’s ICAAP framework is very much aligned to KFH Group’s ICAAP implementation inclusive of these rationalised efforts:

- Adoption of KFH Group Risk Appetite Framework;
- Implementation of KFH Group Integrated Risk Management System (“IRMS”) which provides standardised risk assessment system for the Group; and
- Participation in and support of KFH Group’s 5-year Capital Plan.

The Bank leverages on ICAAP in assessing the overall capital adequacy in relation to its risk profile and take necessary steps to strengthen the risk and capital management capability. The Bank has completed the ‘Capital Appropriation and Preservation’ (“CAP”) initiative to operationalise the capital optimisation strategies that were incorporated in the ICAAP document with the primary objective to reduce capital wastage to optimise capital consumption.

2 STATEMENT OF CORPORATE GOVERNANCE (Cont'd.)

(iii) Risk Management (Cont'd.)

Capital Adequacy Framework Initiatives (Cont'd.)

Pillar 3

The Bank is also in compliance with the BNM CAFIB – Disclosure Requirements (Pillar 3) which specifies the disclosure requirements for credit, market and operational risks.

Stress Test

The stress test and scenario analysis serves as an important tool to assess the financial risks and management capability of the Bank, to continue operating effectively under stressed scenarios. The stress test and scenario analysis assists the BRMC and the Bank's senior management in:

- Evaluating the optimal capitalisation level for the Bank to weather extreme banking scenarios;
- Understanding the nature and key risk profiles of the Bank;
- Developing adequate contingency plans and strategies; and
- Assessing the effectiveness of established risk mitigants.

The preparation of the stress test involves risk management teams, business units, Economist of the Bank and KFH Kuwait. The stress test results are computed using the IRMS based on predefined scenarios which are as follows:

- Economic Recession Scenario;
- Generalised Credit Quality Deterioration and Asset Price Devaluation Scenario; and
- Severe Liquidity Stress and Run on the Bank.

The stress test reports are presented at the Senior Management and Board committees and the results are also discussed with BNM on a regular basis.

DIRECTORS' REPORT

The directors have pleasure in presenting their report together with the audited financial statements of the Group and the Bank for the financial year ended 31 December 2013.

PRINCIPAL ACTIVITIES

The Bank is principally engaged in the Islamic banking business as allowed under the Islamic Financial Services Act, 2013.

The principal activities of the subsidiaries are the provisions of offshore banking, nominees services, fund management and asset management.

There have been no significant changes in the nature of the principal activities during the financial year.

RESULTS

	Group RM'000	Bank RM'000
Net profit for the year	97,740	94,395

In the opinion of the directors, the results of the operations of the Group and the Bank during the financial year were not substantially affected by any item, transaction or event of a material and unusual nature.

DIVIDENDS

No dividend has been paid or declared by the Bank since the end of the previous financial year. The directors do not recommend any dividend payment for the current financial year.

DIRECTORS

The names of the directors of the Bank in office since the date of the last report and at the date of this report are:

Dr. Nabeel A E A Al-Mannae (Chairman)
Shaheen H A KH SH Alghanem (Deputy Chairman)
Khalid Sufat
Mohamed Zaheer Mohamed Azreen
Gopala Krishnan A/L K Sundaram
Dr Paul Quigley
Md Adnan Md Zain (Appointed on 15 January 2014)
Dato' Sri Abdul Hamidy Abdul Hafiz (Resigned on 20 March 2013)
Abdul Wahab I.A.A. AlRushood (Expiry of term of office on 28 August 2013)

DIRECTORS' BENEFITS

Neither at the end of the financial year, nor at any time during that financial year, did there subsist any arrangements to which the Bank is a party whereby directors might acquire benefits by means of the acquisition of shares in, or debenture of the Bank or any other body corporate.

Since the end of the previous financial year, no director of the Bank has received or become entitled to receive any benefit (other than directors' remuneration as disclosed in Note 34 of the financial statements) by reason of a contract made by the Bank or a related corporation with the director or with a firm of which the director is a member, or with a company in which the director has substantial financial except for those transactions carry in the ordinary course of business as disclosed in Note 37 to the financial statements.

DIRECTORS' INTERESTS

According to the register of directors' shareholdings, none of the directors held shares in the Bank and its related corporations during the financial year ended 31 December 2013.

CHANGES IN SHARE CAPITAL

The total paid-up share capital decreased from RM2,266,125,000 to RM1,425,272,000 in March 2013 pursuant to the capital reduction exercise. KFHMB's share capital of RM2,266,125,000 consisting of RM2,266,125,000 ordinary shares of RM1.00 each has been reduced by the cancellation of RM840,853,000 issued and fully paid up shares of the Bank of RM1.00 each.

The capital reduction was implemented by way of cancellation of the issued and paid-up share capital of the Bank under Section 64 of the Companies Act, 1965 in pursuant to order granted from High Court of Malaya on 5 March 2013, confirming the proposed capital reduction consequent to the special resolution approved by the shareholder in the EGM on 21 December 2012.

RESERVES, PROVISIONS AND ALLOWANCES

There were no material transfers to or from reserves or provisions or allowances during the year other than those disclosed in Notes 9, 28, 29 and the statements of changes in equity of the financial statements.

COMPLIANCE WITH BANK NEGARA MALAYSIA'S EXPECTATIONS ON FINANCIAL REPORTING

In preparation of the financial statements, the Directors have taken reasonable steps to ensure that Bank Negara Malaysia's expectations on financial reporting have been complied with, including those as set out in Guidelines on Financial Reporting for Islamic Banking Institutions and the Guidelines on Classification and Impairment Provisions for Loans/Financing.

OTHER STATUTORY INFORMATION

(a) Before the statements of financial position and income statements of the Group and the Bank were made out, the directors took reasonable steps:

   (i) to ascertain that proper actions had been taken in relation to the writing off of bad debts and the making of allowances for doubtful debts and satisfied themselves that all known bad debts had been written off and that adequate allowances had been made for doubtful debts; and

   (ii) to ensure that any current assets which were unlikely to realise their value as shown in the accounting records in the ordinary course of business had been written down to an amount which they might be expected so to realise.

(b) At the date of this report, the directors are not aware of any circumstances which would render:

   (i) the amount written-off for bad debts or the amount of allowances for bad debts in the financial statements of the Group and the Bank inadequate to any substantial extent; and

   (ii) the values attributed to the current assets in the financial statements of the Group and of the Bank misleading.

(c) At the date of this report, the directors are not aware of any circumstances which have arisen which would render adherence to the existing method of valuations of assets or liabilities of the Group and of the Bank misleading or inappropriate.

(d) At the date of this report, the directors are not aware of any circumstances not otherwise dealt with in this report or the financial statements of the Group and of the Bank which would render any amount stated in the financial statements misleading.

OTHER STATUTORY INFORMATION (Cont'd.)

(e) As at the date of this report, there does not exist:

(i) any charge on the assets of the Group or of the Bank which has arisen since the end of the financial year which secures the liabilities of any other person; or

(ii) any contingent liability of the Group and of the Bank which has arisen since the end of the financial year other than those arising in the normal course of business of the Group and of the Bank.

(f) In the opinion of the directors:

(i) no contingent liability or other liability has become enforceable or is likely to become enforceable within the period of twelve months after the end of the financial year which will or may affect the ability of the Group and of the Bank to meet its obligations as and when they fall due; and

(ii) no item, transaction or event of a material and unusual nature has arisen in the interval between the end of the financial year and the date of this report which is likely to affect substantially the results of the operations of the Group or of the Bank for the financial year in which this report is made.

BUSINESS PLAN FOR 2014

The Bank expects to achieve the same objectives of building a stronger financing base and sustainability in the earnings stream as well as enhance the quality of asset in 2014. The Bank will continue to focus on several strategic thrusts namely sustainability and enhance quality asset, cost optimisation and building internal capability.

For 2014, the Bank will further build and strengthen its internal capability by introducing new business lines, enhancing existing IT infrastructure, core processes and human resource practices. The enhancement of existing IT infrastructure will be done through initiatives that are in line with the Bank's IT Strategic Plan to support the business. The Bank also expects to benefit from the strengthening of credit process which was implemented in 2013 and this will enhance the credit and asset quality. Human Capital initiatives is set to continue to strengthen the human resource of the Bank.

With these focused initiatives the Bank believes the customers will be better served and further heightened the competitiveness of the Bank. The Bank expects better performance in 2014.

OUTLOOK FOR 2014

The Malaysian economy is expected to remain on a broadly steady growth at 5% in 2014. Domestic demand will continue to be the main driver of overall growth in 2014 with gross fixed investment is expected to expand during the year as more infrastructure projects get under way. The consumer price inflation is expected to accelerate above 3% in 2014 as a result of increase in electricity tariffs from January 2014. However, it is also expected that the government to resume its subsidy rationalisation programme and a further drop in global oil prices will keep the prices in check. Expansion in exports of goods and services should also pick up amid a sluggish recovery in other parts of the world. It is expected that a gradual improvement in external conditions from 2014 to boost overseas sales and to strengthen Malaysian demand for imports and the trade surplus will remain sizeable throughout the year. The central bank, Bank Negara Malaysia ("BNM") held its overnight policy rate (OPR) at 3% at its monetary policy meeting in November 2013. It is forecasted that a pick-up in global economic activity in 2014, coupled with continued expansion in domestic demand, will prompt BNM to tighten policy during the year.

RATING BY EXTERNAL RATING AGENCY

Rating Agency	Date	Current Rating	Outlook
Malaysian Rating Corporation Berhad (MARC)	10 December 2013	AA+ / MARC-1	Stable

DISCLOSURE OF SHARIAH COMMITTEE

The Bank's business activities are subject to the Shariah compliance and conformation as advised by the Shariah Committee. Seven (7) Shariah Committee meetings were held and thirty four (34) Notes were issued during the financial year. The Shariah Committee comprises of five (5) qualified Shariah scholars who are appointed by the Board for a two-year term as follows:

(a) Sheikh Prof. Dr. Mohammad Abdul Razaq Al-Tabtabae (Chairman)
(b) Sheikh Dr. Anwar Shuaib Abdulsalam (Member)
(c) Sheikh Dr. Adnan Ali Ibrahim Al-Mulla (Member)
(d) Sheikh Isa Abdulla Yusuf Dowaishan (Member)
(e) Sheikh Dr. Engku Muhammad Tajuddin Engku Ali (Member)

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DISCLOSURE OF SHARIAH COMMITTEE (Cont'd.)

The duties and responsibilities of the Shariah Committee among others are as follows:

(a) To advise the Board of Directors on Shariah matters in order to ensure that the business operations of the Bank comply with the Shariah principles at all times;

(b) To evaluate and endorse sample of contracts, agreements of the Bank's transactions;

(c) To clarify Shariah rulings in relation to the Bank's transactions as observed by the Committee based on what was referred to them by the Board of Directors, the Chairman or the Shariah Division;

(d) To present Shariah's views to the Board of Directors in relation to any matter raised in regards to the transactions of the Bank;

(e) To confirm that the Bank’s transactions and contracts are in compliance with Shariah via reports submitted by the Shariah Advisor/Shariah Division to the Shariah Committee on a periodic basis, explaining the activities and the implementation of the fatwa and rulings issued by the Shariah Committee. The Shariah Committee shall rectify any shortcomings to ensure its conformity to Shariah;

(f) To provide written Shariah opinion. The Shariah Committee is required to record any opinion given. In particular, the Shariah Committee shall prepare written Shariah opinions in the following circumstances:

    (i) when the Bank makes reference to the Shariah Advisory Council (“SAC”) of Bank Negara Malaysia for advice; and

    (ii) when the Bank submits applications to Bank Negara Malaysia for the approval of new products in accordance with guidelines on product approval issued by Bank Negara Malaysia; and

(g) To review annual financial statements of the Bank.

ZAKAT OBLIGATIONS

Kuwait Finance House K.S.C who is the shareholder of Kuwait Finance House (Malaysia) Berhad paid zakat on behalf of the Bank. The Bank does not pay zakat on behalf of the shareholder or depositors.

AUDITORS

The auditors, Ernst & Young, have expressed their willingness to continue in office.

Signed on behalf of the Board in accordance with a resolution of the directors dated 27 January 2014.

KHALID BIN SUFAT
Director

MOHAMED ZAHEER MOHAMED AZREEN
Director

KUWAIT FINANCE HOUSE (MALAYSIA) BERHAD

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STATEMENT BY DIRECTORS
Pursuant To Section 169 (15) of the Companies Act, 1965

We, Khalid bin Sufat and Mohamed Zaheer Mohamed Azreen, being two of the directors of Kuwait Finance House (Malaysia) Berhad, do hereby state that, in the opinion of the directors, the accompanying financial statements set out on pages 34 to 202 are drawn up in accordance with Malaysian Financial Reporting Standards, International Financial Reporting Standards and the requirements of the Companies Act, 1965 in Malaysia so as to give a true and fair view of the financial position of the Group and of the Bank as at 31 December 2013 and of the results and the cash flows of the Group and of the Bank for the year then ended.

Signed on behalf of the Board in accordance with a resolution of the directors dated 27 January 2014.

KHALID BIN SUFAT
Director

MOHAMED ZAHEER MOHAMED AZREEN
Director

KUWAIT FINANCE HOUSE (MALAYSIA) BERHAD

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STATUTORY DECLARATION
Pursuant To Section 169 (16) of the Companies Act, 1965

I, Dato' Sri Abdul Hamidy Abdul Hafiz, being the director primarily responsible for the financial management of Kuwait Finance House (Malaysia) Berhad, do solemnly and sincerely declare that the accompanying financial statements set out on pages 34 to 202, are in my opinion correct and I make this solemn declaration conscientiously believing the same to be true, and by virtue of the provisions of the Statutory Declarations Act, 1960.

Subscribed and solemnly declared by the
abovenamed Dato' Sri Abdul Hamidy Abdul Hafiz
at Kuala Lumpur, in the Federal Territory on 27 January 2014

BEFORE ME:

Commissioner for Oaths

KUWAIT FINANCE HOUSE (MALAYSIA) BERHAD

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REPORT OF SHARIAH COMMITTEE

In the name of Allah, the most Beneficent, the most Merciful.

Praise to Allah, the Lord of the Worlds and peace and blessings be upon our Prophet Muhammad, and on his scion and companions.

Assalamualaikum Warahmatullahi Wabarakatuh.

In compliance with the Guidelines on the Shariah Committee of Kuwait Finance House (Malaysia) Berhad we are required to submit the following report:

We have reviewed and approved the policies, products and the contracts relating to the transactions and applications undertaken by Kuwait Finance House (Malaysia) Berhad and its subsidiaries ("the Group") during the year ended 31 December 2013. We have also conducted our review to form an opinion as to whether Kuwait Finance House (Malaysia) Berhad has complied with Shariah rules and principles and also with the Shariah rulings issued by us.

Kuwait Finance House (Malaysia) Berhad's Management is responsible for ensuring that the Bank conducts its business in accordance with Shariah rules and principles. It is our responsibility to form our independent opinion, based on our review of the operations of Kuwait Finance House (Malaysia) Berhad, and to report to you.

We conducted our review through Shariah Division and approved samples of contracts, agreements and reviewed operations related to the transactions of Kuwait Finance House (Malaysia) Berhad's with shareholder, investors and others. This has been done by selecting random samples according to the annual Shariah Review Plan on all departments, and by regular reports submitted by Shariah Division regarding the review process, field visits, conduct of business and proper implementation of decisions issued by the Committee.

We obtained all information and explanations which we consider necessary in order to provide us with sufficient evidence to give reasonable assurance that Kuwait Finance House (Malaysia) Berhad has not violated the Shariah rules and principles in all transactions that had been presented to us.

In our opinion:

(a) the contracts, transactions and dealings entered into by Kuwait Finance House (Malaysia) Berhad and the Group during the year ended 31 December 2013 that we have reviewed are in compliance with Shariah rules and principles;

(b) the allocation of profits and losses relating to investment accounts conform to the basis that had been approved by us in accordance with Shariah rules and principles;

(c) all earnings that have been realised from sources or by means prohibited by Shariah rules and principles, have been put aside in a separate account and disposed of to charitable causes;

(d) the calculation of Zakat is in compliance with Shariah rules and principles; and

(e) The Shariah non-compliance events and action taken to remedy such non-compliance events are as disclosed in Note 48.

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REPORT OF SHARIAH COMMITTEE

This opinion is rendered based on what has been presented to us by the Management of Kuwait Finance House (Malaysia) Berhad and its Shariah Division.

We pray to Allah the Almighty to grant us success and the path of straight-forwardness.

Wassalamualaikum Wa Rahmatullahi Wabarakatuh.

Sheikh Prof. Dr. Mohammad Abdul Razaq Al-Tabtabae
Chairman
Signature:

Date:

Sheikh Dr. Anwar Shuaib Abdulsalam
Member
Signature:

Date:

Sheikh Dr. Adnan Ali Ibrahim Al-Mulla
Member
Signature:

Date:

Sheikh Isa Abdulla Yusuf Dowaishan
Member
Signature:

Date:

Sheikh Dr. Engku Muhammad Tajuddin Engku Ali
Member
Signature:

Date: 27 January 2014

Kuala Lumpur, Malaysia

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Independent auditors' report to the member of
Kuwait Finance House (Malaysia) Berhad
(Incorporated in Malaysia)

We have audited the financial statements of Kuwait Finance House (Malaysia) Berhad, which comprise statements of financial position as at 31 December 2013 of the Group and of the Bank, and income statements, statements of comprehensive income, statements of changes in equity and statements of cash flows of the Group and of the Bank for the year then ended, and a summary of significant accounting policies and other explanatory information, as set out on pages 34 to 202.

Directors' responsibility for the financial statements

The directors of the Bank are responsible for the preparation of financial statements so as to give a true and fair view in accordance with Malaysian Financial Reporting Standards, International Financial Reporting Standards and the requirements of the Companies Act, 1965 in Malaysia. The directors are also responsible for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with approved standards on auditing in Malaysia. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Bank's preparation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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Independent auditors' report to the member of
Kuwait Finance House (Malaysia) Berhad (Cont'd.)
(Incorporated in Malaysia)

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Group and of the Bank as at 31 December 2013 and of their financial performance and cash flows for the year then ended in accordance with Malaysian Financial Reporting Standards, International Financial Reporting Standards and the requirements of the Companies Act, 1965 in Malaysia.

Report on other legal and regulatory requirements

In accordance with the requirements of the Companies Act, 1965 in Malaysia, we also report the following:

(a) In our opinion, the accounting and other records and the registers required by the Act to be kept by the Bank and its subsidiaries of which we have acted as auditors have been properly kept in accordance with the provisions of the Act.

(b) We have considered the financial statements and the auditors' report of the subsidiary of which we have not acted as auditors, which are indicated in Note 14 to the financial statements, being financial statements that have been included in the consolidated financial statements.

(c) We are satisfied that the financial statements of the subsidiaries that have been consolidated with the financial statements of the Bank are in form and content appropriate and proper for the purposes of the preparation of the consolidated financial statements and we have received satisfactory information and explanations required by us for those purposes.

(d) The auditors' reports on the financial statements of the subsidiaries were not subject to any qualification and in respect of the subsidiaries incorporated in Malaysia, did not include any comment required to be made under Section 174(3) of the Act.

Independent auditors' report to the member of
Kuwait Finance House (Malaysia) Berhad (Cont'd.)
(Incorporated in Malaysia)

Other matters

This report is made solely to the member of the Bank, as a body, in accordance with Section 174 of the Companies Act, 1965 in Malaysia and for no other purpose. We do not assume responsibility to any other person for the content of this report.

Ernst & Young
AF: 0039
Chartered Accountants

Chan Hooi Lam
No. 2844/02/14(J)
Chartered Accountant

Kuala Lumpur, Malaysia
27 January 2014

KUWAIT FINANCE HOUSE (MALAYSIA) BERHAD

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STATEMENTS OF FINANCIAL POSITION

		Group	
		2013	**2012**
	Note	**RM'000**	**RM'000**
ASSETS			
Cash and short-term funds	4	1,406,209	1,400,684
Deposits and placements with banks and other financial institutions	5	75,902	244,147
Securities held-for-trading	6	-	79,493
Hedging financial instruments	11	15,192	21,470
Securities available-for-sale	7	1,188,943	955,830
Securities held-to-maturity	8	81,486	81,493
Financing, advances and other receivables	9	6,009,772	5,288,745
Other assets	10	195,570	208,882
Statutory deposit with Bank Negara Malaysia	12	182,200	191,717
Musyarakah capital investment	13	5,898	5,898
Property and equipment	15	34,189	37,352
Intangible assets	16	14,264	21,840
Deferred tax assets	17	241,258	286,641
TOTAL ASSETS		**9,450,883**	**8,824,192**
LIABILITIES			
Deposits from customers	18	5,342,642	5,370,265
Deposits and placements of banks and other financial institutions	19	1,771,560	1,324,476
Hedging financial instruments	11	200	16,754
Subordinated Murabahah Tawarruq	22	415,577	374,054
Other liabilities	20	331,290	219,348
TOTAL LIABILITIES		**7,861,269**	**7,304,897**
SHAREHOLDER'S EQUITY			
Share capital	23	1,425,272	2,266,125
Reserves	24	164,342	(746,830)
TOTAL SHAREHOLDER'S EQUITY		**1,589,614**	**1,519,295**
TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY		**9,450,883**	**8,824,192**

KUWAIT FINANCE HOUSE (MALAYSIA) BERHAD

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STATEMENTS OF FINANCIAL POSITION (CONT'D.)

		Group	
		2013	**2012**
	Note	**RM'000**	**RM'000**
COMMITMENTS AND CONTINGENCIES	38	1,172,841	2,120,234
CAPITAL ADEQUACY			
CET 1/Tier 1 capital ratio	40	18.01%	15.44%
Total capital ratio/Risk-weighted capital ratio	40	21.78%	19.45%
NET ASSETS PER SHARE (RM)		1.12	0.67

The accompanying notes form an integral part of the financial statements.

KUWAIT FINANCE HOUSE (MALAYSIA) BERHAD

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STATEMENTS OF FINANCIAL POSITION

	Note	Bank 2013 RM'000	Bank 2012 RM'000
ASSETS			
Cash and short-term funds	4	1,431,875	1,370,167
Deposits and placements with banks and other financial institutions	5	75,902	228,838
Securities held-for-trading	6	-	79,493
Hedging financial instruments	11	15,192	21,470
Securities available-for-sale	7	1,090,608	846,614
Securities held-to-maturity	8	81,486	81,493
Financing, advances and other receivables	9	6,009,772	5,288,745
Other assets	10	195,420	208,756
Statutory deposit with Bank Negara Malaysia	12	182,200	191,717
Musyarakah capital investment	13	5,898	5,898
Investment in subsidiaries	14	19,432	30,952
Property and equipment	15	33,748	36,491
Intangible assets	16	13,469	21,169
Deferred tax assets	17	241,134	286,538
TOTAL ASSETS		**9,396,136**	**8,698,341**
LIABILITIES			
Deposits from customers	18	5,320,777	5,377,039
Deposits and placements of banks and other financial institutions	19	1,753,737	1,204,490
Hedging financial instruments	11	200	16,754
Subordinated Murabahah Tawarruq	22	415,577	374,054
Other liabilities	20	330,448	218,505
TOTAL LIABILITIES		**7,820,739**	**7,190,842**
SHAREHOLDER'S EQUITY			
Share capital	23	1,425,272	2,266,125
Reserves	24	150,125	(758,626)
TOTAL SHAREHOLDER'S EQUITY		**1,575,397**	**1,507,499**
TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY		**9,396,136**	**8,698,341**

KUWAIT FINANCE HOUSE (MALAYSIA) BERHAD

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STATEMENTS OF FINANCIAL POSITION (CONT'D.)

		Bank	
		2013	**2012**
	Note	**RM'000**	**RM'000**
COMMITMENTS AND CONTINGENCIES	38	1,172,841	2,120,234
CAPITAL ADEQUACY			
CET 1/ Tier 1 capital ratio	40	17.40%	15.41%
Total capital ratio/ Risk-weighted capital ratio	40	21.20%	18.89%
NET ASSETS PER SHARE (RM)		1.11	0.67

The accompanying notes form an integral part of the financial statements.

KUWAIT FINANCE HOUSE (MALAYSIA) BERHAD

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INCOME STATEMENTS

		Group		Bank	
	Note	2013 RM'000	2012 RM'000	2013 RM'000	2012 RM'000
Operating revenue	25	463,999	494,405	462,114	485,695
Income derived from investment of depositors' funds and others	26	340,008	383,841	337,983	377,207
Income derived from investment of shareholder's equity	27	123,991	110,564	124,131	108,488
Total gross income		463,999	494,405	462,114	485,695
Impairment write back on financing, advances and other receivables	28	108,082	14,464	108,082	14,464
Impairment loss and allowances on investments	29	(3,399)	(4,949)	(14,919)	(1,507)
Total distributable income		568,682	503,920	555,277	498,652
Income attributable to the depositors	30	(181,380)	(193,596)	(181,245)	(193,409)
Total net income		387,302	310,324	374,032	305,243
Personnel expenses	31	(118,033)	(101,352)	(112,548)	(97,753)
Other overheads and expenditures	32	(106,296)	(105,027)	(101,866)	(100,598)
Finance cost	33	(14,395)	(13,551)	(14,395)	(13,551)
Profit before zakat and taxation		148,578	90,394	145,223	93,341
Taxation	35	(50,838)	(29,900)	(50,828)	(29,851)
Net profit for the year		97,740	60,494	94,395	63,490
Attributable to:					
- Equity holder of the Bank		97,740	60,494	94,395	63,490
Earning per share (sen)					
- Basic/ Diluted	36	6.86	4.24		

The accompanying notes form an integral part of the financial statements.

KUWAIT FINANCE HOUSE (MALAYSIA) BERHAD

(672174-T)

(Incorporated in Malaysia)

STATEMENTS OF COMPREHENSIVE INCOME

	Group		Bank	
	2013 RM'000	**2012 RM'000**	**2013 RM'000**	**2012 RM'000**
Net profit for the year	97,740	60,494	94,395	63,490
Other comprehensive (loss)/ income:				
Items that may be reclassified subsequenty to profit or loss:				
Securities available-for-sale:				
- Net unrealised (loss)/ gain on securities available-for-sale	(31,297)	9,354	(28,287)	8,152
- Net realised loss/ (gain) on securities available-for-sale reclassified to the income statement	189	(4,464)	127	(4,683)
Exchange differences on translation of foreign operations:				
- Net gain/ (loss) taken to equity	2,024	(1,051)	-	-
Income tax relating to components of other comprehensive income (Note 17)	1,663	991	1,663	991
Other comprehensive (loss)/ income for the year, net of tax	(27,421)	4,830	(26,497)	4,460
Total comprehensive income for the year	70,319	65,324	67,898	67,950
Total comprehensive income for the year attributable to equity holder of the Bank	70,319	65,324	67,898	67,950

The accompanying notes form an integral part of the financial statements.

KUWAIT FINANCE HOUSE (MALAYSIA) BERHAD

(672174-T)

(Incorporated in Malaysia)

STATEMENTS OF CHANGES IN EQUITY

		Non-distributable			Distributable	
	Share Capital RM'000	Statutory Reserve RM'000	Exchange Fluctuation Reserve RM'000	Available-For-Sale Reserve RM'000	Retained Earning/ (Accumulated Losses) RM'000	Total RM'000
Group						
At 1 January 2013	2,266,125	66,697	(7,112)	2,574	(808,989)	1,519,295
Effect of capital reduction (Note 23)	(840,853)	-	-	-	840,853	-
Total comprehensive income/ (loss)	-	-	2,024	(29,445)	97,740	70,319
Transfer to statutory reserve	-	47,198	-	-	(47,198)	-
At 31 December 2013	1,425,272	113,895	(5,088)	(26,871)	82,406	1,589,614
At 1 January 2012	2,266,125	34,952	(6,061)	(3,307)	(837,738)	1,453,971
Total comprehensive (loss)/ income	-	-	(1,051)	5,881	60,494	65,324
Transfer to statutory reserve	-	31,745	-	-	(31,745)	-
At 31 December 2012	2,266,125	66,697	(7,112)	2,574	(808,989)	1,519,295
Bank						
At 1 January 2013	2,266,125	66,697	-	355	(825,678)	1,507,499
Effect of capital reduction (Note 23)	(840,853)	-	-	-	840,853	-
Total comprehensive (loss)/ income	-	-	-	(26,497)	94,395	67,898
Transfer to statutory reserve	-	47,198	-	-	(47,198)	-
At 31 December 2013	1,425,272	113,895	-	(26,142)	62,372	1,575,397
At 1 January 2012	2,266,125	34,952	-	(4,105)	(857,423)	1,439,549
Total comprehensive income	-	-	-	4,460	63,490	67,950
Transfer to statutory reserve	-	31,745	-	-	(31,745)	-
At 31 December 2012	2,266,125	66,697	-	355	(825,678)	1,507,499

The accompanying notes form an integral part of the financial statements.

KUWAIT FINANCE HOUSE (MALAYSIA) BERHAD

(672174-T)

(Incorporated in Malaysia)

STATEMENTS OF CASH FLOWS

	Group		Bank	
	2013	**2012**	**2013**	**2012**
	RM'000	**RM'000**	**RM'000**	**RM'000**
CASH FLOWS FROM OPERATING ACTIVITIES				
Profit before zakat and taxation	148,578	90,394	145,223	93,341
Adjustments for:				
Impairment write back on financing, advances and other receivables (Note 28)	(63,910)	(4,307)	(63,910)	(4,307)
Amortisation of premium less accretion of discounts (Notes 26 and 27)	4,565	5,065	4,565	5,066
Finance cost (Note 33)	14,395	13,551	14,395	13,551
Depreciation of property and equipment (Note 32)	11,607	12,084	11,449	11,902
Amortisation of intangible assets (Note 32)	9,043	8,672	8,808	8,516
Gain on disposal of property and equipment (Note 27)	(367)	-	(384)	-
Gain on disposal of ijarah automobile	(24)	-	(24)	-
Net gains on sale of securities available-for-sale (Notes 26 and 27)	(1,166)	(20,309)	(1,166)	(19,915)
Net gains on sale of securities held-for-trading (Notes 26 and 27)	(1,410)	(3,485)	(1,410)	(3,508)
Impairment allowance on securities available-for-sale and others (Note 29)	3,399	4,949	3,399	1,507
Impairment on subsidiaries (Note 29)	-	-	11,520	-
Unrealised loss on foreign translations	3,649	19,404	3,789	19,409
Unrealised gain on securities held-for-trading, and hedging financial instruments (Note 27)	(10,217)	(33,902)	(10,217)	(33,902)
Operating profit before working capital changes	118,142	92,116	126,037	91,660
Decrease/ (increase) in operating assets				
Deposits and placements with banks and other financial institutions	168,245	490,826	152,935	506,135
Financing, advances and other receivables	(657,118)	(86,674)	(657,118)	(86,674)
Other assets	35,069	147,886	30,918	134,958
Statutory deposit with Bank Negara Malaysia	9,517	(11,517)	9,517	(11,517)

KUWAIT FINANCE HOUSE (MALAYSIA) BERHAD

(672174-T)

(Incorporated in Malaysia)

STATEMENTS OF CASH FLOWS

	Group		Bank	
	2013 RM'000	**2012 RM'000**	**2013 RM'000**	**2012 RM'000**
CASH FLOWS FROM OPERATING ACTIVITIES (Cont'd.)				
(Decrease)/ increase in operating liabilities				
Deposits from customers	(27,623)	652,410	(56,261)	657,451
Deposits and placements of banks and other financial institutions	447,084	(1,810,096)	549,247	(1,947,551)
Other liabilities	113,605	(145,445)	113,607	(145,093)
Cash used in operations	206,921	(670,494)	268,882	(800,631)
Tax refunded	105	8,163	-	8,215
Tax paid	(1,880)	-	(1,880)	-
Zakat paid	-	(3,740)	-	(3,740)
Net cash generated from/(used in) operating activities	**205,146**	**(666,071)**	**267,002**	**(796,156)**
CASH FLOWS FROM INVESTING ACTIVITIES				
Net proceeds from (purchases)/ sales of securities	(185,084)	133,525	(195,920)	121,087
Proceeds from disposal of property and equipment	391	-	391	-
Proceeds from disposal of ijarah automobile	56	-	56	-
Purchase of property and equipment (Note 15)	(9,452)	(30,224)	(9,436)	(29,413)
Purchase of intangible assets (Note 16)	(444)	(2,446)	(385)	(1,638)
Net cash (used in)/generated from investing activities	**(194,533)**	**100,855**	**(205,294)**	**90,036**
Net increase/(decrease) in cash and cash equivalents	**10,613**	**(565,216)**	**61,708**	**(706,120)**
Cash and cash equivalents at beginning of year	1,400,684	1,973,012	1,370,167	2,076,287
Exchange differences on translation of opening balances	(5,088)	(7,112)	-	-
Cash and cash equivalents at end of year (Note 4)	**1,406,209**	**1,400,684**	**1,431,875**	**1,370,167**

The accompanying notes form an integral part of the financial statements.

NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2013

1 PRINCIPAL ACTIVITIES AND GENERAL INFORMATION

The Bank is engaged in Islamic banking business as allowed under the Islamic Financial Services Act 2013. The principal activities of the subsidiaries are the provisions of offshore banking, nominees services, fund management and asset management, as set out in Note 14. There have been no significant changes in the nature of the principal activities during the financial year.

The Bank is a licensed Islamic Bank under the Islamic Financial Services Act 2013, incorporated and domiciled in Malaysia. The registered office of the Bank is located at Level 26, Menara Prestige, No. 1, Jalan Pinang, P.O.Box 10103, 50450 Kuala Lumpur, Malaysia.

The holding company of the Bank is Kuwait Finance House K.S.C., a public limited liability company, incorporated in Kuwait on 23 March 1977 and is registered as an Islamic Bank with the Central Bank of Kuwait. The registered office of Kuwait Finance House K.S.C. is located at 13110, Abdulla Al-Mubarak Street, Murgab, Kuwait.

The financial statements were authorised for issue by the Board of Directors in accordance with a resolution of the directors on 27 January 2014.

2 BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS

The financial statements of the Group and of the Bank have been prepared in accordance with Malaysian Financial Reporting Standards (“MFRS”), International Financial Reporting Standards ("IFRS") and the requirements of the Companies Act, 1965 in Malaysia.

The financial statements of the Group and of the Bank have been prepared under the historical cost basis unless otherwise indicated in the summary of significant accounting policies as disclosed in Note 3.1.

The Group and the Bank present the statements of financial position in order of liquidity. An analysis regarding the recovery of settlement within 12 months after the reporting date (current) and more than 12 months after the reporting date (non-current) is presented in Note 46.

Certain qualitative disclosures under MFRS 7 *Financial Instruments: Disclosures* about the nature and extent of risks and capital management disclosures under MFRS 101 *Presentation of Financial Statements (Revised)* have been included in the audited parts of the "Risk Management" section in the Statement of Corporate Governance.

The financial statements are presented in Ringgit Malaysia (RM) and all values are rounded to the nearest thousand (RM'000) except where otherwise indicated.

3 SIGNIFICANT ACCOUNTING POLICIES

3.1 Summary of Significant Accounting Policies

(a) Basis of Accounting

The financial statements of the Group and the Bank have been prepared on the historical cost basis unless otherwise disclosed in the accounting policies below.

(b) Subsidiaries and Basis of Consolidation

(i) Subsidiaries

Subsidiaries are entities over which the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Specifically, the Group controls an investee if and only if the Group has:

- Power over the investee (i.e. existing rights that give it the current ability to direct the relevant activities of the investee)
- Exposure, or rights, to variable returns from its involvement with the investee, and
- The ability to use its power over the investee to affect its returns

When the Group has less than a majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including:

- The contractual arrangement with the other vote holders of the investee
- Rights arising from other contractual arrangements
- The Group's voting rights and potential voting rights

The Group re-assesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control.

In the Bank's separate financial statements, investment in subsidiaries is stated at cost less impairment losses. On disposal of such investment, the difference between the net disposal proceeds and their carrying amount is included in profit or loss.

3 SIGNIFICANT ACCOUNTING POLICIES

3.1 Summary of Significant Accounting Policies

(b) Subsidiaries and Basis of Consolidation (Cont'd.)

(ii) Basis of Consolidation

The consolidated financial statements comprise the financial statements of the Bank and its subsidiaries as at the reporting date. The financial statements of the subsidiaries are prepared for the same reporting date as the Bank.

Subsidiaries are consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date that such control ceases. In preparing the consolidated financial statements, intragroup balances, transactions and unrealised gains or losses are eliminated in full. Uniform accounting policies are adopted in the consolidated financial statements for like transactions and events in similar circumstances.

Non-controlling interests ("NCI") represent the portion of profit or loss and net assets in subsidiaries not owned, directly or indirectly by the Bank. NCI are presented separately in the consolidated income statements and statements of comprehensive income and within equity in the consolidated statement of financial position, but separate from parent shareholders' equity. Total comprehensive income is allocated against the interest of NCI, even if this results in a deficit balance. Acquisition of NCI are accounted for using the parent entity extension method, whereby the difference between the consideration and the fair value of the share of the net assets acquired is recognised as equity.

A change in the ownership interest of a subsidiary, without loss of control, is accounted for as an equity transaction. If the Group loses control over a subsidiary, it:

- Derecognises the assets (including goodwill) and liabilities of the subsidiary at their carrying amounts;
- Derecognises the carrying amount of any non-controlling interest in the former subsidiary;
- Derecognises the cumulative foreign exchange translation differences recorded in equity;
- Recognises the fair value of the consideration received;
- Recognises the fair value of any investment retained in the former subsidiary;
- Recognises any surplus or deficit in the profit or loss; and
- Reclassifies the parent's share of components previously recognised in other comprehensive income to profit or loss or retained earnings, if required in accordance with other MFRSs.

All of the above will be accounted for from the date when control is lost.

3 SIGNIFICANT ACCOUNTING POLICIES (Cont'd.)

3.1 Summary of Significant Accounting Policies (Cont'd.)

(c) Fair value measurement

The Group measures financial instruments such as security available-for-sale and hedging financial instruments at fair value at each reporting date.

Financial instruments such as those categorized as securities held-to-maturity and financing, advances and other receivables are measured at amortised cost.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- In the principal market for the asset or liability, or
- In the absence of a principal market, in the most advantageous market for the asset or liability

The principal or the most advantageous market must be accessible to by the Group.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

The Group does not have any non-financial instruments that are measured at fair value as at reporting date.

The Group uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

All financial assets and liabilities for which fair value is measured or disclosed in the financial statements are categorised within the fair value hierarchy described in Note 42.

3 SIGNIFICANT ACCOUNTING POLICIES (Cont'd.)

3.1 Summary of Significant Accounting Policies (Cont'd.)

(d) Financial assets

Financial assets are recognised in the statements of financial position when the Group and the Bank become a party to the contractual provisions of the financial instruments.

When financial assets are recognised initially, they are measured at fair value, plus, in the case of financial assets not at fair value through profit or loss, directly attributable transaction costs.

Classification of financial assets are determined at initial recognition, which is described below.

(i) Financial assets at fair value through profit and loss ("FVTPL")

Financial assets at FVTPL consist of investment in securities held-for-trading and hedging financial instruments.

Securities held-for-trading are acquired or incurred principally for the purpose of selling or repurchasing in the near term or they are part of a portfolio of identified securities that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. Securities classified as held-for-trading are stated at fair value and any gain or loss arising from a change in the fair value are recognised in profit or loss.

Profit from securities held-for-trading calculated using the effective yield rate method, is recognised in profit or loss.

The estimated fair values for securities held-for-trading are based on quoted and observable market prices at the reporting date. Where such quoted and observable market prices are not available, fair value is estimated using pricing models or discounted cash flow techniques. Where discounted cash flow technique is used, the estimated future cash flows are discounted based on current market rates for similar instruments at the reporting date.

The accounting policies in relation to hedging financial instruments are disclosed in Note 3.1 (o).

(ii) Financing, advances and other receivables

Financing, advances and other receivables are recognised when cash is disbursed to customers. They are initially stated at fair value including any direct transaction cost and are subsequently measured at amortised cost using the effective yield rate method. Gains and losses are recognised in profit or loss when the financing, advances and other receivables are derecognised or impaired, and through the amortisation process.

3 SIGNIFICANT ACCOUNTING POLICIES (Cont'd.)

3.1 Summary of Significant Accounting Policies (Cont'd.)

(d) Financial assets (Cont'd.)

(ii) Financing, advances and other receivables (Cont'd.)

The Group and the Bank assess at each reporting date whether there is any objective evidence that financing, advances and other receivables are impaired. Financing, advances and other receivables are classified as impaired when:

(i) where the principal or profit or both is past due for more than 90 days or 3 months;

(ii) where the amount is past due for 3 months or less, the financing exhibits certain credit weaknesses;

(iii) where repayments are scheduled on intervals of 3 months or longer, the financing is classified as impaired as soon as a default occurs, unless it does not exhibit any weakness; and

(iv) rescheduled and restructured facilities can only be reclassified as non-impaired when repayments based on the revised or restructured terms have been observed continuously for a minimum period of six months.

To determine whether there is objective evidence that an impairment loss has been incurred, the Group and the Bank consider factors such as significant financial difficulties of the customer and default or significant delay in repayments.

The amount of impairment loss is measured as the difference between the carrying amount of the financing and the present value of estimated future cash flows discounted at the financing's original effective yield rate. The impairment loss is recognised in income statement.

The carrying amount of the financial asset is reduced by the impairment loss through the use of an impairment allowance account. When a financing becomes uncollectible, it is written off against the allowance account.

If in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed to the extent that the carrying amount of the asset does not exceed its amortised cost at the reversal date. The amount of reversal is recognised in income statement.

3 SIGNIFICANT ACCOUNTING POLICIES (Cont'd.)

3.1 Summary of Significant Accounting Policies (Cont'd.)

(d) Financial assets (Cont'd.)

(ii) Financing, advances and other receivables (Cont'd.)

As allowed by MFRS 139, the collective assessment for impairment for the Group and the Bank are estimated with reference to publically available peer group experience for comparable segments for each financing portfolio. The peer group historical loss experience used by the Group and the Bank are Probability of Default (“PD”) and Loss Given Default (“LGD”) estimates. These estimates are mapped and calibrated to the Group’s and the Bank's financing portfolios using equivalent and comparable credit ratings as references.

(iii) Securities held-to-maturity

Securities held-to-maturity are securities with fixed or determinable payments and fixed maturity that the Group and the Bank have the positive intention and ability to hold the investment to maturity. These investments are measured at amortised cost using the effective yield rate method. A gain or loss is recognised in profit or loss when the securities are derecognised or impaired, and through the amortisation process.

The impairment loss, for investments held at amortised cost, is measured as the difference between the securities' carrying amount and the present value of estimated future cash flows discounted at its original effective yield rate on initial recognition. The carrying amount of the securities shall be reduced either directly or through use of an allowance account.

If, in subsequent periods, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss will be reversed either directly or by adjusting the allowance account. The reversal will not result in the carrying amount of securities exceeding what the amortised cost would have been had the impairment not been recognised at the date the impairment is reversed. The amount of the reversal will be recognised in profit or loss.

3 SIGNIFICANT ACCOUNTING POLICIES (Cont'd.)

3.1 Summary of Significant Accounting Policies (Cont'd.)

(d) Financial assets (Cont'd.)

(iv) Securities available-for-sale

Securities available-for-sale are securities that are not classified as held-for-trading or held-to-maturity investments and are measured at fair value. Investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured or where the revaluation technique generates a wide range of possible fair values and the probability of various outcomes cannot be estimated are stated at cost less impairment. Any gain or loss arising from a change in the fair value are recognised in other comprehensive income, except for impairment losses, foreign exchange gains or losses and profit calculated using the effective yield rate method are recognised in profit or loss.

Profit from securities available-for-sale, calculated using the effective yield rate method, is recognised in profit or loss while dividends on equity instruments available-for-sale and property funds are recognised in profit or loss when the Group's and the Bank's right to receive payment is established.

In the event of any objective evidence that the securities are impaired, the cumulative loss that had been recognised in other comprehensive income will be removed and recognised in profit or loss even though the securities have not been derecognised. The amount of cumulative loss is measured as the difference between the acquisition cost (net of any principal repayment or amortisation) and current fair value, less any impairment loss on that securities previously recognised in profit or loss.

For equity instruments and other securities stated at cost, the amount of impairment loss is measured as the difference between the carrying amount of securities and the present value of estimated future cash flows discounted at the current market rate of return for similar securities. Such impairment loss shall not be reversed.

For financing converted into debt or equity instruments, the Bank will measure the security or equity instruments received at its fair value. The difference between the net book value of the restructured financing (outstanding amount of financing net of individual impairment) and the fair value of the security or equity instruments will be the gain or loss from the conversion scheme.

3 SIGNIFICANT ACCOUNTING POLICIES (Cont'd.)

3.1 Summary of Significant Accounting Policies (Cont'd.)

(d) Financial assets (Cont'd.)

(iv) Securities available-for-sale (Cont'd.)

- where the net book value of the restructured financing is higher than the fair value of the debt or equity instruments, the loss shall be recognised in the profit and loss in the current reporting period.

- where the fair value of the debt or equity instruments is higher than the net book value of the restructured financing, the gain from the conversion scheme is transferred to the "Impairment loss" account, which would be netted off from the "Securities" account in the statements of financial position.

The estimated fair values for securities available-for-sale are based on quoted and observable market prices at the reporting date. Where such quoted and observable market prices are not available, fair value is estimated using pricing models or discounted cash flow techniques. Where discounted cash flow technique is used, the estimated future cash flows are discounted based on current market rates for similar instruments at the reporting date.

A financial asset is derecognised when the contractual right to receive the cash flows from the asset has expired. On derecognition of a financial asset in its entirety, the difference between the carrying amount and the sum of the consideration received and any cumulative gain or loss that had been recognised in other comprehensive income is recognised in profit or loss.

Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace concerned. All regular way purchases and sales of financial assets are recognised or derecognised on the trade date i.e., the date that the Group and the Bank commit to purchase or sell the asset.

(e) Financial liabilities

Financial liabilities are recognised in the statement of financial position when the Group and the Bank become a party to the contractual provisions of the financial instrument. Financial liabilities are initially recognised at fair value plus directly attributable transaction costs, and subsequently measured at amortised cost using the effective yield method.

Deposits from customers, deposits and placements of banks and financial institutions and Subordinated Murabahah Tawarruq are measured at amortised cost. With the exception of hedging financial instruments, the Group and the Bank do not have any financial liabilities classified at fair value through profit and loss.

3 SIGNIFICANT ACCOUNTING POLICIES (Cont'd.)

3.1 Summary of Significant Accounting Policies (Cont'd.)

(f) Property and Equipment, and Depreciation

All items of property and equipment are initially recorded at cost. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the Bank and the cost of the item can be measured reliably. The carrying amount of the replaced parts is derecognised. All other repairs and maintenance are charged to the profit or loss during the financial period in which they are incurred.

Subsequent to recognition, property and equipment except for work-in-progress are stated at cost less accumulated depreciation and any accumulated impairment losses.

Work-in-progress are not depreciated as these assets are not available for use. Depreciation of other property and equipment is provided for on a straight-line-basis to write off the cost of each asset to its residual value over the estimated useful life, as follows:

Renovation	5 years
Furniture and fittings	5 years
Office equipment	5 years
Computer equipment hardware	5 years
Motor vehicles	5 years

The residual values, useful life and depreciation method are reviewed at each financial year-end to ensure that the amount, method and period of depreciation are consistent with previous estimates and the expected pattern of consumption of the future economic benefits embodied in the items of property and equipment.

An item of property and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. The difference between the net disposal proceeds, if any and the net carrying amount is recognised in profit or loss.

(g) Intangible Assets

(i) Goodwill

Goodwill acquired in a business combination is initially measured at cost being the excess of the cost of business combination over the Group's interest in the fair value of the identifiable assets, liabilities and contingent liabilities. Following the initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is not amortised but instead, it is reviewed for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

3 SIGNIFICANT ACCOUNTING POLICIES (Cont'd.)

3.1 Summary of Significant Accounting Policies (Cont'd.)

(g) Intangible Assets (Cont'd.)

(ii) Other Intangible Assets

Intangible assets acquired separately are measured initially at cost. The cost of intangible assets acquired in a business combination is their fair values as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or infinite. Intangible assets with finite lives are amortised on a straight-line basis over the estimated economic useful lives and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method for an intangible asset with a finite useful life are reviewed at least at each reporting date.

Intangible assets with indefinite useful lives are not amortised but tested for impairment annually or more frequently if the events or changes in circumstances indicate that the carrying value may be impaired either individually or at the cash-generating unit level. The useful life of an intangible asset with an indefinite life is also reviewed annually to determine whether the useful life assessment continues to be supportable.

Intangible asset for computer software is amortised over the useful lives of 5 years.

(h) Other Assets

Other assets are carried at anticipated realisable values. Bad debts are written off when identified. An estimate is made for doubtful debts based on a review of all outstanding amounts as at the reporting date.

(i) Musyarakah Capital Investment and Musyarakah Financing

The Bank grants Musyarakah financing as part of the Bank's activities in accordance with the principles of Shariah. The equity participation that forms part of the financing structure is called Musyarakah capital investment. Musyarakah capital investment is carried at cost less any impairment loss. Under the principle of Musyarakah, the Bank and its partners shall contribute a portion of capital and the proportion of profit to be distributed between the partners must be mutually pre-agreed upon inception of the contract. In view of the Bank acting as a financier to the project, Musyarakah financing is carried as financing receivable in the financial statements of the Bank. The profit on Musyarakah financing is recognised over the term of the contract based on estimated internal rate of return of the project.

3 SIGNIFICANT ACCOUNTING POLICIES (Cont'd.)

3.1 Summary of Significant Accounting Policies (Cont'd.)

(j) Provision for Liabilities

Provision for liabilities are recognised when the Group and the Bank have a present obligation as a result of a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount can be made.

Provisions are reviewed at each reporting date and adjusted to reflect the current best estimate. Where the effect of the time value of money is material, the amount of the provision is the present value of the expenditure expected to be required to settle the obligation.

(k) Income Tax

(i) Current tax

Current tax assets and liabilities are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the reporting date.

Current taxes are recognised in profit or loss except to the extent that the tax relates to items recognised outside profit or loss, either in other comprehensive income or directly in equity.

(ii) Deferred tax

Deferred tax is provided using the liability method on temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognised for all temporary differences, except:

- where the deferred tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

- in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

3 SIGNIFICANT ACCOUNTING POLICIES (Cont'd.)

3.1 Summary of Significant Accounting Policies (Cont'd.)

(k) Income Tax (Cont'd.)

(ii) Deferred tax (Cont'd.)

Deferred tax assets are recognised for all deductible temporary differences, carry forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry forward of unused tax credits and unused tax losses can be utilised except:

- where the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

- in respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are recognised only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Unrecognised deferred tax assets are reassessed at each reporting date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax assets to be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted at the reporting date.

Deferred tax relating to items recognised outside profit or loss is recognised outside profit or loss. Deferred tax items are recognised in correlation to the underlying transaction either in other comprehensive income or directly in equity and deferred tax arising from a business combination is adjusted against goodwill on acquisition.

Deferred tax assets and deferred tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

3 SIGNIFICANT ACCOUNTING POLICIES (Cont'd.)

3.1 Summary of Significant Accounting Policies (Cont'd.)

(l) Revenue Recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the Bank and the revenue can be reliably measured. The following specific criteria must also be met before revenue is recognised:

(i) Finance Income Recognition

Finance income is recognised on an effective yield basis. Income on cash line, house and term financing are accounted for by reference to the rest periods as stipulated in the financing agreement, which are either daily or monthly. Income on Musyarakah and Mudharabah financing are recognised based on estimated internal rate of return.

Customers' accounts are classified as impaired where repayments are in arrears for more than three months from the first day of default for financing and one month after maturity date for trade bills and other instruments of similar nature.

(ii) Fee and Other Income Recognition

Financing arrangement, management and participation fees, underwriting commissions and brokerage fees are recognised as income based on contractual arrangements. Due to the short term nature of financial guarantees issued by the Group and the Bank, guarantee fee (administrative fee) is recognised as income upon issuance of the guarantee. Fees from advisory and corporate finance activities are recognised net of service taxes and discounts on completion of each stage of the assignment. Other fees and commissions on services and facilities extended to customers are recognised on inception of such transactions.

Dividend income from subsidiary and other investments are recognised when the Group's and the Bank's right to receive payment is established.

3 SIGNIFICANT ACCOUNTING POLICIES (Cont'd.)

3.1 Summary of Significant Accounting Policies (Cont'd.)

(m) Profit Expense Recognition

Attributable profit expense on deposits and financing of the Group and the Bank are recognised on an accrual basis.

(n) Foreign Currencies

(i) Functional and Presentational Currency

The individual financial statements of each entity in the Group are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The consolidated financial statements are presented in Ringgit Malaysia (RM), which is also the Bank's functional currency.

(ii) Foreign Currency Transactions

In preparing the financial statements of the individual entities, transactions in currencies other than the Bank's functional currency (foreign currencies) are recorded in the functional currencies using the exchange rates prevailing at the dates of the transactions. At each reporting date, monetary items denominated in foreign currencies are translated at the rates prevailing on the reporting date. Non-monetary items carried at fair value that are denominated in foreign currencies are translated at the rates prevailing on the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not translated.

Exchange differences arising on the settlement of monetary items, and on the translation of monetary items, are included in income statement for the period except for exchange differences arising on monetary items that form part of the Group's net investment in foreign operations. These are initially taken directly to the foreign currency translation reserve within equity until the disposal of the foreign operations, at which time they are recognised in profit or loss. Exchange differences arising on monetary items that form part of the Bank's net investment in foreign operation are recognised in profit or loss in the Bank's separate financial statements or the individual financial statements of the foreign operation, as appropriate.

Exchange differences arising on the translation of non-monetary items carried at fair value are included in profit or loss for the period except for the differences arising on the translation of non-monetary items in respect of which gains and losses are recognised directly in equity. Exchange differences arising from such non-monetary items are also recognised directly in equity.

3 SIGNIFICANT ACCOUNTING POLICIES (Cont'd.)

3.1 Summary of Significant Accounting Policies (Cont'd.)

(n) Foreign Currencies (Cont'd.)

(iii) Foreign Operations

The results and financial position of the subsidiaries that have functional currencies different from the presentation currency (RM) of the consolidated financial statements are translated into RM as follows:

(a) Assets and liabilities for each statement of financial position presented are translated at the closing rates prevailing at the reporting date;

(b) Income and expenses for each income statement are translated at month-end exchange rates, which approximates the exchange rates at the dates of the transactions; and

(c) All resulting exchange differences are taken to the foreign currency translation reserve in other comprehensive income.

(o) Hedging financial instruments

The initial recognition of hedging financial instruments is at fair value, and subsequently remeasured at fair value with the resulting gain or loss recognised in profit or loss. Hedging financial instruments with positive fair values are classified as financial assets and as financial liabilities when their fair values are negative.

(i) Foreign Exchange Contracts

Foreign exchange trading positions, including spot and forward contracts, are revalued at prevailing market rates at the reporting date and the resultant gains and losses are recognised in profit or loss.

(ii) Profit Rate, Foreign Currency and Ijarah Rental Swaps

These financial instruments are measured at fair value and are carried as assets when the fair value is positive and as liabilities when the fair value is negative. Any gain or loss arising from a change in the fair value of these financial instruments is recognised in profit or loss unless they are part of a hedging relationship which qualifies for hedge accounting where the gain or loss is recognised as follows:

3 SIGNIFICANT ACCOUNTING POLICIES (Cont'd.)

3.1 Summary of Significant Accounting Policies (Cont'd.)

(o) Hedging financial instruments (Cont'd.)

(ii) Profit Rate, Foreign Currency and Ijarah Rental Swaps (Cont'd.)

Fair value hedge

Where a financial instrument hedges the changes in fair value of a recognised asset or liability, any gain or loss on the hedging instrument is recognised in profit or loss. The hedged item is also stated at fair value in respect of the risk being hedged, with any gain or loss being recognised in profit or loss.

Cash flow hedge

Gains and losses on the hedging instrument, to the extent that the hedge is effective, are deferred in a separate component of equity. The ineffective part of any gain or loss is recognised in profit or loss. The deferred gains and losses are released to profit or loss in the periods when the hedged item affects the profit or loss.

(p) Employee Benefits

(i) Short-Term Benefits

Wages, salaries, bonuses and social security contributions are recognised as an expense in the financial year in which the associated services are rendered by employees of the Group and the Bank. Short-term accumulating compensated absences such as paid annual leave are recognised when services are rendered by employees that increases their entitlement to future compensated absences. Short-term non-accumulating compensated absences such as sick leave are recognised when the absences occur.

(ii) Defined Contribution Plan

Defined contribution plan is a post-employment benefit plan under which the Group and the Bank pay fixed contributions into separate entities or funds and will have no legal or constructive obligation to pay further contributions if any of the funds do not hold sufficient assets to pay all employee benefits relating to employee services in the current and preceding financial years. Such contributions are recognised as an expense in the profit or loss when incurred. As required by law, companies in Malaysia make such contributions to the Employees Provident Fund (“EPF”).

3 SIGNIFICANT ACCOUNTING POLICIES (Cont'd.)

3.1 Summary of Significant Accounting Policies (Cont'd.)

(q) Zakat

This represents business zakat. It is an obligatory amount payable by the Bank to comply with the principles of Shariah. Zakat would be paid by Kuwait Finance House K.S.C who is the main shareholder of Kuwait Finance House (Malaysia) Berhad.

(r) Profit Equalisation Reserves ("PER")

PER is the amount appropriated out of total gross income in order to maintain a certain level of return to depositors in confirmity with Bank Negara Malaysia's "The Framework of Rate of Return (BNM/GP2-i)".

The Bank does not maintain PER as the Bank has been utilising income from shareholder's fund to stabilise the rate of return to depositors.

(s) Impairment of Non-Financial Assets

The carrying amounts of assets (other than investment in subsidiaries, associated companies and deferred tax assets) are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated to determine the amount of impairment loss.

For the purpose of impairment testing of these assets, recoverable amount is determined on an individual asset basis unless the asset does not generate cash flows that are largely independent of those from other assets. If this is the case, recoverable amount is determined for the cash-generating unit (CGU) to which the asset belongs to. Goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's CGUs, or groups of CGUs, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the Group are assigned to those units or groups of units.

3 SIGNIFICANT ACCOUNTING POLICIES (Cont'd.)

3.1 Summary of Significant Accounting Policies (Cont'd.)

(s) Impairment of Non-Financial Assets (Cont'd.)

An asset's recoverable amount is the higher of an asset's or CGU's fair value less costs to sell and its value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. Impairment losses recognised in respect of a CGU or groups of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to those units or groups of units and then, to reduce the carrying amount of the other assets in the unit or groups of units on a pro-rata basis.

An impairment loss is recognised in income statement in the period in which it arises, unless the asset is carried at a revalued amount, in which case the impairment loss is accounted for as a revaluation decrease to the extent that the impairment loss does not exceed the amount held in the asset revaluation reserve for the same asset.

(t) Financial Instruments

Financial instruments are recognised in the statements of financial position when the Group and the Bank have become a party to the contractual provisions of the financial instrument. The accounting policies on recognition and measurement of these items are disclosed in their respective accounting policies.

Financial instruments are classified as liabilities or equity in accordance with the substance of the contractual arrangement. Profits, dividends and gains or losses relating to a financial instrument classified as a liability, are reported as expense or income. Distributions to holders of financial instruments classified as equity are charged directly to equity. Financial instruments are offset when the Group and the Bank have a legally enforceable right to offset and intends to settle either on a net basis or to realise the asset and settle the liability simultaneously.

(u) Cash and Cash Equivalents

Cash and cash equivalents include cash and bank balances and short-term deposits with remaining maturities of less than one month.

3 SIGNIFICANT ACCOUNTING POLICIES (Cont'd.)

3.1 Summary of Significant Accounting Policies (Cont'd.)

(v) Financial Risk Management Objective and Policies

The Group's and the Bank's financial risk management policy seek to ensure that adequate financial resources are available for the development of the Group's and the Bank's business whilst managing its profit rate risks (both fair value and cash flow), liquidity risk and credit risk. The Board reviews and agrees policies for managing each of these risks as disclosed in the Statement of Corporate Governance.

(w) Operating Lease

Under the operating lease, the Group and the Bank act as a lessee. The operating lease payments are accounted for on a straight-line basis over the lease term and included in "Other overheads and expenditures".

3.2 Changes in Accounting Policies

The accounting policies adopted are consistent with those of the previous financial year except for the adoption of the following MFRS, Amendments to MFRS, IC Interpretation and Technical Release:

Amendments to MFRSs contained in the documents entitled "Annual Improvements 2009-2011 Cycle
MFRS 3 *Business Combinations (IFRS 3 Business Combinations issued by IASB in March 2004)*
MFRS 10 *Consolidated Financial Statements*
MFRS 11 *Joint Arrangements*
MFRS 12 *Disclosure of interests in Other Entities*
MFRS 13 *Fair Value Measurement*
MFRS 119 *Employee Benefits (As amended by IASB in June 2011)*
MFRS 127 *Separate Financial Statements (As amended by IASB in May 2011)*
MFRS 128 *Investment in Associate and Joint Ventures (As amended by IASB in May 2011)*
MFRS 127 *Consolidated and Separate Financial Statements (IAS 27 Consolidated and Separate Financial Statements as revised by IASB in December 2003)*
IC Interpretation 20 *Stripping Costs in the Production Phase of a Surface Mine*
Amendments to MFRS 7: *Disclosures – Offsetting Financial Assets and Financial Liabilities*
Amendments to MFRS 1: *First-time Adoption of Malaysian Financial Reporting Standards – Government Loans*

3 SIGNIFICANT ACCOUNTING POLICIES (Cont'd.)

3.2 Changes in Accounting Policies (Cont'd.)

Amendments to MFRS 10: *Consolidated Financial Statements: Transition Guidance*
Amendments to MFRS 11: *Joint Arrangements: Transition Guidance*
Amendments to MFRS 12: *Disclosure of Interests in Other Entities: Transition Guidance*
Presentation of Items of Other Comprehensive Income (Amendments to MFRS 101)

Adoption of the above standards and interpretations did not have any effect on the financial performance or position of the Group and the Bank except for as discussed below:

MFRS 13 Fair Value Measurement

MFRS 13 establishes a single source of guidance under MFRS for all fair value measurements. MFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under MFRS. MFRS 13 defines fair value as an exit price. As a result of the guidance in MFRS 13, the Group re-assessed its policies for measuring fair values. IFRS 13 also requires additional disclosures.

Application of MFRS 13 has not materially impacted the fair value measurements of the Group. Additional disclosures where required, are provided in the individual notes relating to the assets and liabilities whose fair values were determined. Fair value hierarchy is provided in Note 42.

3.3 Standards issued but not yet effective

The standards and interpretations that are issued but not yet effective up to the date of issuance of the Group's and the Bank's financial statements are disclosed below. The Group and the Bank intend to adopt these standards, if applicable, when they become effective.

MFRSs, Amendments to MFRSs and Interpretations	Effective for financial period beginning on or after
Amendments to MFRS 132: *Offsetting Financial Assets and Financial Liabilities*	1 January 2014
Amendments to MFRS 10, MFRS 12 and MFRS 127: *Investment Entities*	1 January 2014
Amendments to MFRS 136: *Recoverable Amount Disclosures for Non-Financial Assets*	1 January 2014
Amendments to MFRS 139: *Novation of Derivatives and Continuation of Hedge Accounting*	1 January 2014
IC interpretation 21: *Levies*	1 January 2014
Amendments to MFRS 119: *Defined Benefit Plans: Employee Contribution*	1 July 2014
Amendments to MFRS contained in the documents entitled " Annual Improvements 2010 - 2012 cycle"	1 July 2014
Amendments to MFRS contained in the documents entitled " Annual Improvements 2011 - 2013 cycle"	1 July 2014
MFRS 9 *Financial Instruments (IFRS 9 issued by IASB in November 2009)*	To be decided
MFRS 9 *Financial Instruments (IFRS 9 issued by IASB in October 2010)*	To be decided
MFRS 9 *Financial Instruments (Hedge Accounting and amendments to MFRS 9, MFRS 7 and MFRS 139)*	To be decided

3 SIGNIFICANT ACCOUNTING POLICIES (Cont'd.)

3.3 Standards issued but not yet effective (Cont'd.)

The Group and the Bank plan to apply the abovementioned standards when they become effective:

Amendments to MFRS 132 Offsetting Financial Assets and Financial Liabilities

These amendments clarify the meaning of “currently has a legally enforceable right to set-off”. It will be necessary to assess the impact to the Group and the Bank by reviewing settlement procedures and legal documentation to ensure that offsetting is still possible in cases where it has been achieved in the past. In certain cases, offsetting may no longer be achieved. In other cases, contracts may have to be renegotiated. The requirement that the right of set-off be available for all counterparties to the netting agreement may prove to be a challenge for contracts where only one party has the right to offset in the event of default.

The amendments also clarify the application of the MFRS 132 offsetting criteria to settlement systems (such as central clearing house systems) which apply gross settlement mechanisms that are not simultaneous. Offsetting on the grounds of simultaneous settlement is particularly relevant for the Group and the Bank as to where it engages in large numbers of sale and repurchase transactions. Currently, transactions settled through clearing systems are, in most cases, deemed to achieve simultaneous settlement. While many settlement systems are expected to meet the new criteria, some may not. Any changes in offsetting are expected to impact leverage ratios, regulatory capital requirements, etc. As the impact of the adoption depends on the Bank’s examination of the operational procedures applied by the central clearing houses and settlement systems it deals with to determine if they meet the new criteria, it is not practical to quantify the effects. These amendments become effective for annual periods beginning on or after 1 January 2014.

Amendments to MFRS 10, MFRS 12 and MFRS 127: Investment Entities

These amendments are effective for annual periods beginning on or after 1 January 2014 provide an exception to the consolidation requirement for entities that meet the definition of an investment entity under MFRS 10. The exception to consolidation requires investment entities to account for subsidiaries at fair value through profit or loss. It is not expected that this amendment would be relevant to the Group, since none of the entities in the Group would qualify to be an investment entity under MFRS 10.

Amendments to MFRS 136: Recoverable Amount Disclosures for Non-Financial Assets

The amendment clarifies that recoverable amount (determined based on fair value less costs of disposal) is required to be disclosed only when an impairment loss is recognised or reversed. In addition, there are new disclosure requirements about fair value measurement when impairment or reversal of impairment is recognised. These amendments become effective for annual periods beginning on or after 1 January 2014.

3 SIGNIFICANT ACCOUNTING POLICIES (Cont'd.)

3.3 Standards issued but not yet effective (Cont'd.)

Amendments to MFRS 139: Novation of Derivatives and Continuation of Hedge Accounting

These amendments provide relief from discontinuing hedge accounting when novation of a derivative designated as a hedging instrument meets certain criteria. These amendments are effective for annual periods beginning on or after 1 January 2014. The Group has not novated its derivatives during the current period. However, these amendments would be considered for future novations.

Amendments to MFRS 119: Defined Benefit Plans: Employee Contributions

The Amendments provide a practical expedient in accounting for contributions from employees or third parties to defined benefit plans.

If the amount of the contributions is independent of the number of years of service, an entity is permitted to recognise such contributions as a reduction in the service cost in the period in which the related service is rendered, instead of attributing the contributions to the periods of service.

However, if the amount of the contributions is dependent on the number of years of service, an entity is required to attribute those contributions to periods of service using the same attribution method required by MFRS 119 for the gross benefit (i.e. either based on the plan's contribution formula or on a straight-line basis).

The Amendments are effective for annual periods beginning on or after 1 July 2014 with earlier application permitted.

MFRS 9 Financial Instruments: Classification and Measurement

MFRS 9, as issued, reflects the first phase of the IASB's work though the adoption date is subject to the recently issued Exposure Draft on the replacement of MFRS 139 and applies to classification and measurement of financial assets and liabilities as defined in MFRS 139. The standard was initially effective for annual periods beginning on or after 1 January 2013, but Amendments to MFRS 9 Mandatory Effective Date of MFRS 9 and Transition Disclosures, issued in December 2011, moved the mandatory effective date to 1 January 2015.

In subsequent phases, the IASB will address impairment and hedge accounting. In addition, IASB has decided that a mandatory date of 1 January 2015 would not allow sufficient time for entities to prepare to apply the new standard because the impairment phase of IFRS 9 has not yet been completed. On 24 July 2013, the IASB tentatively decided to defer the mandatory effective date of IFRS 9 and that the mandatory effective date should be left open pending finalisation of the impairment and classification and measurement requirements. Nevertheless, IFRS 9 would still be available for early application.The Bank will quantify the effect of the adoption of the first phase of MFRS 9 in conjunction with the other phases, when issued, to present a comprehensive picture.

3 SIGNIFICANT ACCOUNTING POLICIES (Cont'd.)

3.3 Standards issued but not yet effective (Cont'd.)

MFRS 9 Financial Instruments (Hedge Accounting and amendments to MFRS 9, MFRS 7 and MFRS 139)

The new hedge accounting model together with corresponding disclosures about risk management activity were developed in response to concerns raised by preparers of financial statements about the difficulty of appropriately reflecting their risk management activities. The new model represents a substantial overhaul of hedge accounting that will enable entities to better reflect their risk management activities in their financial statements. The most significant improvements apply to those that hedge non-financial risk, and they are expected to be of particular interest to non-financial institutions. As a result of these changes, users of the financial statements will be provided with better information about risk management and about the effect of hedge accounting on the financial statements. The MFRS 9 hedge accounting model, if adopted, applies prospectively with limited exceptions.

As part of the Amendments, an entity is now allowed to change the accounting for liabilities that it has elected to measure at fair value, before applying any of the other requirements in MFRS 9. This change in accounting would mean that gains caused by a worsening in the entity's own credit risk on such liabilities are no longer recognised in profit or loss. The Amendments will facilitate earlier application of this long-awaited improvement to financial reporting.

The Amendments also remove the mandatory effective date from MFRS 9. However, an entity may still choose to apply MFRS 9 immediately. The new effective date will be decided when the IASB's IFRS 9 project is closer to completion.

3.4 Significant Accounting Estimates and Judgments

The preparation of the financial statements involved making certain estimates, assumptions and judgments that affect the accounting policies applied and reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the financial statements in the period in which the estimate is revised and in any future periods affected. Significant areas of estimation, uncertainty and critical judgments used in applying accounting policies that have significant effect on the amount recognised in the financial statements include the following:

3 SIGNIFICANT ACCOUNTING POLICIES (Cont'd.)

3.4 Significant Accounting Estimates and Judgments (Cont'd.)

(a) Impairment losses on financing, advances and other receivables

The Bank review its individually significant financing and advances at each reporting date to assess whether an impairment loss should be recorded in profit or loss. In particular, judgment by management is required in the estimation of the amount and timing of future cash flows when determining the impairment loss. In estimating these cash flows, the Bank make judgments about the borrower's or the customer's financial situation and the net realisable value of collateral. These estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the allowances.

Financing and advances that have been assessed individually but for which no impairment is required and all individually insignificant financing and advances are then assessed collectively, in groups of assets with similar risk characteristics, to determine whether allowances should be made due to incurred loss events for which there is objective evidence but whose effects are not yet evident. The collective assessment takes account of data from the financing portfolio (such as credit quality, levels of arrears, credit utilisation, financing to collateral ratios etc.) and judgements on the effects of concentrations of risks (such as the performance of different individual groups).

(b) Fair value estimation of securities and profit rate related contracts

As disclosed in Note 3.1(c), where the quoted and observable market prices of certain securities are not available, fair value is estimated using pricing models or discounted cash flow techniques. The usage of these models and techniques require the Group to make certain estimates and assumptions, including but not limited to estimated future cash flows and discount rates.

(c) Deferred tax and income taxes

Significant judgment is required in estimating the provision for income taxes. There are many transactions and interpretations of tax law for which the final outcome will not be established until some time later. Liabilities for taxation are recognised based on estimates of whether additional taxes will be payable. The estimation process includes seeking advice on tax treatments where appropriate. Where the final liability for taxation is different from the amounts that were intially recorded, the differences will affect the income tax and deferred tax provisions in the period in which the estimate is revised or the final liability is established.

Deferred tax assets are measured and recognised based on the tax rates that are expected to apply in the period when the asset is realised. Estimates are made as to the amount of taxable profits in these periods which will enable the deferred tax assets to be realised.

(d) Income recognition on Musyarakah and Mudharabah financing

Musyarakah and Mudharabah financing income are recognised based on estimated internal rate of return which is revised periodically over the duration of the financing.

	Group		Bank	
	2013 RM'000	**2012 RM'000**	**2013 RM'000**	**2012 RM'000**
4 CASH AND SHORT-TERM FUNDS				
Cash and balances with banks and other financial institutions	78,982	84,852	77,807	84,037
Money at call and interbank placements with remaining maturity less than one month	1,327,227	1,315,832	1,354,068	1,286,130
	1,406,209	1,400,684	1,431,875	1,370,167
5 DEPOSITS AND PLACEMENTS WITH BANKS AND OTHER FINANCIAL INSTITUTIONS				
Licensed Islamic banks	50,005	65,365	50,005	50,056
Other financial institutions	25,897	178,782	25,897	178,782
	75,902	244,147	75,902	228,838
6 SECURITIES HELD-FOR-TRADING				
At fair value				
Unquoted Islamic private debt securities/ sukuk	-	79,493	-	79,493
7 SECURITIES AVAILABLE-FOR-SALE				
At fair value				
Unquoted securities				
Islamic private debt securities/ sukuk	385,991	425,320	372,571	365,264
Government guaranteed sukuk	583,149	435,181	538,057	422,143
Mutual Fund	65,515	-	65,515	-
	1,034,655	860,501	976,143	787,407
At cost				
Unquoted shares in Malaysia	87,700	25,000	87,700	25,000
Property funds	39,823	36,122	-	-
Collective Investment Scheme	26,765	34,207	26,765	34,207
	154,288	95,329	114,465	59,207
	1,188,943	955,830	1,090,608	846,614

8 SECURITIES HELD-TO-MATURITY

	Group and Bank 2013 RM'000	Group and Bank 2012 RM'000
At amortised cost		
Unquoted securities:		
Islamic private debt securities/ sukuk	81,486	81,493

9 FINANCING, ADVANCES AND OTHER RECEIVABLES

	Group and Bank 2013 RM'000	Group and Bank 2012 RM'000
(i) At amortised cost		
Term financing		
- House financing	414,635	374,814
- Personal financing	1,443,259	1,206,109
- Leasing financing	153,057	166,402
- Syndicated financing	374,233	320,841
- Cashline financing	4,603	-
- Hire purchase receivables	184,364	125,107
- Other term financing	3,932,840	3,770,400
Staff financing	9,784	10,496
	6,516,775	5,974,169
Less: Impairment allowances on financing		
- Collective assessment	(190,926)	(138,600)
- Individual assessment	(316,077)	(546,824)
Net financing, advances and other receivables	6,009,772	5,288,745
(ii) By contract		
Ijarah Muntahia Bittamlik/ Al-Ijarah Thumma Al-Bai' (lease ended with ownership)	1,883,974	1,678,438
Murabahah (cost-plus)	4,196,002	3,804,411
Mudharabah (profit sharing)	80,223	99,244
Musyarakah (profit and loss sharing)	353,112	385,158
Qard (benevolent financing)	535	899
Istisna'	2,929	6,019
	6,516,775	5,974,169

9 FINANCING, ADVANCES AND OTHER RECEIVABLES (Cont'd.)

	Group and Bank	
	2013 RM'000	2012 RM'000
(iii) By type of customer		
Domestic business enterprises		
- Small medium enterprises	985,659	767,997
- Others	3,229,194	3,002,869
Individuals	1,989,138	1,679,217
Other domestic entities	-	121,897
Foreign entities	167,612	294,242
Domestic non-bank financial institutions	145,172	107,947
	6,516,775	5,974,169
(iv) By residual contractual maturity		
Maturity within one year	3,667,380	3,679,744
More than one year to three years	109,438	231,391
More than three years to five years	197,556	93,142
More than five years	2,542,401	1,969,892
	6,516,775	5,974,169
(v) By geographical distribution		
Malaysia	6,437,309	5,832,956
Middle East	15,725	19,287
Other countries	63,741	121,926
	6,516,775	5,974,169
(vi) By profit rate sensitivity		
Fixed rate		
- House financing	83,277	91,915
- Hire purchase receivables	184,364	125,107
- Syndicated financing	374,233	320,841
- Term financing	3,516,971	3,407,749
Variable		
- House financing	331,358	282,899
- Term financing	2,026,572	1,745,658
	6,516,775	5,974,169

9 FINANCING, ADVANCES AND OTHER RECEIVABLES (Cont'd.)

	Group and Bank	
	2013 RM'000	**2012 RM'000**
(vii) By sector		
Construction	287,930	211,000
Electricity, gas and water	119,915	126,300
Finance, insurance and business services	446,468	263,398
Household	2,005,077	1,698,953
Manufacturing	1,006,081	959,776
Mining and quarrying	242,931	308,149
Agriculture, hunting, forestry & fishing	231,144	69,674
Real Estate	1,143,918	1,237,321
Transports, storage and communication	486,144	260,489
Wholesale & retail trade and restaurants & hotels	284,990	358,710
Others	262,177	480,399
	6,516,775	5,974,169
(viii) By economic purpose		
Merger and acquisition	141,109	-
Purchase of transport vehicles	333,691	287,156
Purchase of landed properties		
- residential	542,858	398,497
- non-residential	491,060	318,278
Purchase of fixed assets	342,264	474,134
Working capital	2,051,970	2,176,891
Construction	584,542	469,266
Personal use	1,442,306	1,198,725
Other purposes	586,975	651,222
	6,516,775	5,974,169

9 FINANCING, ADVANCES AND OTHER RECEIVABLES (Cont'd.)

(ix) Financing by types and Shariah contract

2013	Group and Bank						
	Ijarah Muntahia Bittamlik/ Al-Ijarah Thumma Al-Bai'/ (lease ended with ownership)	Murabahah (cost-plus)	Mudharabah (profit sharing)	Musyarakah (profit and loss sharing)	Qard (benevolent financing)	Istisna'	Total
	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000
House financing	370,089	103	-	41,514	-	2,929	414,635
Personal financing	-	1,442,883	-	-	376	-	1,443,259
Leasing financing	60,732	55,717	36,608	-	-	-	153,057
Syndicated financing	195,464	178,769	-	-	-	-	374,233
Cashline financing	-	4,603	-	-	-	-	4,603
Hire purchase receivables	138,119	-	-	46,245	-	-	184,364
Other term financing	1,111,958	2,512,757	43,615	264,510	-	-	3,932,840
Staff financing	7,612	1,170	-	843	159	-	9,784
	1,883,974	4,196,002	80,223	353,112	535	2,929	6,516,775

2012	Group and Bank						
	Ijarah Muntahia Bittamlik/ Al-Ijarah Thumma Al-Bai'/ (lease ended with ownership)	Murabahah (cost-plus)	Mudharabah (profit sharing)	Musyarakah (profit and loss sharing)	Qard (benevolent financing)	Istisna'	Total
	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000
House financing	323,783	107	-	44,905	-	6,019	374,814
Personal financing	-	1,205,748	-	-	361	-	1,206,109
Leasing financing	86,797	61,175	18,430	-	-	-	166,402
Syndicated financing	290,467	30,374	-	-	-	-	320,841
Hire purchase receivables	80,369	-	-	44,738	-	-	125,107
Other term financing	888,920	2,505,760	80,814	294,616	290	-	3,770,400
Staff financing	8,102	1,247	-	899	248	-	10,496
	1,678,438	3,804,411	99,244	385,158	899	6,019	5,974,169

9 FINANCING, ADVANCES AND OTHER RECEIVABLES (Cont'd.)

	Group and Bank 2013 RM'000	Group and Bank 2012 RM'000
(x) Purpose and Source of Qard financing		
As at 1 January	899	1,030
Source of Qard fund:	441	844
- Depositors' Fund	360	701
- Shareholders' Fund	81	143
Uses of Qard fund:	(805)	(975)
- Financing for asset purchase	(775)	(939)
- Staff Benevolent	(30)	(36)
As at 31 December	535	899
(xi) Movements in impaired financing, advances and other receivables		
At 1 January	933,554	1,493,648
- Impaired during the year	165,452	241,451
- Reclassified to performing during the year	(155,197)	(34,483)
- Amount recovered	(138,671)	(213,608)
- Amount written off	(114,512)	(553,454)
At 31 December	690,626	933,554
Ratio of net impaired financing, advances and other receivables to gross financing, advances and other receivables less individual impairment allowance	6.04%	7.13%
(xii) Movements in impairment allowances on financing, advances and other receivables		
Collective assessment		
At 1 January	138,600	140,866
Allowance made/ (reversed) during the year (Note 28)	52,326	(2,266)
At 31 December	190,926	138,600
As % of total gross financing, advances and other receivables less individual impairment allowance	3.08%	2.55%
Individual assessment		
At 1 January	546,824	1,089,878
Allowance (reversed)/ made during the year (Note 28)	(116,236)	3,554
Allowance charged during the period	*85,308*	*134,599*
Allowance written-back during the period	*(201,544)*	*(131,045)*
Amount written off	(114,511)	(546,608)
At 31 December	316,077	546,824

9 FINANCING, ADVANCES AND OTHER RECEIVABLES (Cont'd.)

(xiii) Impaired financing by sector

	Group and Bank	
	2013	**2012**
	RM'000	**RM'000**
Agriculture, hunting, forestry and fishing	-	39,764
Construction	23,179	31,525
Electricity, gas and water	79	18,646
Finance, insurance and business services	22,119	38,576
Household	28,506	12,445
Manufacturing	342,124	306,950
Mining and quarrying	116,393	119,246
Real Estate	56,645	69,919
Transport, storage and communication	56,197	56,719
Wholesale & retail trade and restaurants & hotels	33,950	129,471
Others	11,434	110,293
	690,626	933,554

10 OTHER ASSETS

		Group		Bank	
		2013	**2012**	**2013**	**2012**
	Note	**RM'000**	**RM'000**	**RM'000**	**RM'000**
Deposits and prepayments		10,333	17,672	10,173	17,391
Amount due from holding company	(i)	299	294	299	294
Amount due from subsidiaries	(i)	-	-	4	425
Amount due from other related parties	(i)	615	1,617	615	1,615
Fee receivable		53	2,575	53	2,575
Sundry debtors		22,213	12,408	22,119	12,127
Murabahah trading automobile	(ii)	-	32	-	32
Tax recoverable		3,038	5,005	3,138	5,018
Gold depository		159,019	169,279	159,019	169,279
		195,570	208,882	195,420	208,756

(i) The amount due from holding company, subsidiaries and related parties are unsecured, profit-free and repayable on demand.

10 OTHER ASSETS (Cont'd.)

(ii) Murabahah trading automobile

	Group and Bank	
	2013 RM'000	2012 RM'000
Automobiles (Cost)	-	127
Accumulated depreciation	-	(95)
Total inventories at lower of cost and net realisable value	-	32

All inventories are held for the purpose of Murabahah (cost plus sale) transaction which can be transacted at spot or on deferred basis.

11 HEDGING FINANCIAL INSTRUMENTS

	Notional	Fair Value	
Group and Bank	Amount RM'000	Assets RM'000	Liabilities RM'000
2013			
Ijarah rental swap related contracts	263,825	15,192	200
Total	263,825	15,192	200
2012			
Ijarah rental swap related contracts	278,339	21,470	16,754
Total	278,339	21,470	16,754

12 STATUTORY DEPOSIT WITH BANK NEGARA MALAYSIA

The statutory deposit is maintained with Bank Negara Malaysia in compliance with Section 37(1)(c) of the Central Bank of Malaysia Act, 1958 (Revised 1994), the amount of which is determined at set percentages of total eligible liabilities.

13 MUSYARAKAH CAPITAL INVESTMENT

The Bank grants Musyarakah financing as part of the Bank's activities in accordance with the principles of Shariah. The equity participation that forms part of the financing structure is called Musyarakah capital investment which is carried at cost less any impairment loss. The Bank's participation in these entities involved is limited to safeguarding its interest under the Musyarakah financing.

14 INVESTMENT IN SUBSIDIARIES

	Bank 2013 RM'000	Bank 2012 RM'000
Unquoted shares, at cost		
- in Malaysia	30,200	30,200
- outside Malaysia	15,993	15,993
	46,193	46,193
Impairment on investment in subsidiaries	(26,761)	(15,241)
	19,432	30,952

Details of the subsidiaries are as follows:

Company	Principal Activities	Country of Incorporation	Equity interest held (%) 2013	Equity interest held (%) 2012
Kuwait Finance House (Labuan) Berhad	Offshore banking	Malaysia	100	100
KFH Nominees (Tempatan) Sdn. Bhd.	Nominee services	Malaysia	100	100
Kuwait Finance House (Australia) Pty Ltd ^	Fund management	Australia	100	100
KFH Asset Management Sdn. Bhd.	Asset management	Malaysia	100	100

^ Audited by member firm of Ernst & Young Global in Australia.

15 PROPERTY AND EQUIPMENT

Group 2013	**Renovation RM'000**	**Furniture & fittings RM'000**	**Office equipment RM'000**	**Computer equipment hardware RM'000**	**Motor vehicles RM'000**	**Work-in-progress RM'000**	**Total RM'000**
Cost							
At 1 January	29,762	17,361	16,235	27,783	1,321	1,819	94,281
Additions	3,342	232	341	738	660	4,139	9,452
Disposals	(4,247)	(6,172)	(3,183)	(4,168)	-	-	(17,770)
Write-offs	(282)	-	-	-	-	-	(282)
Transfers	56	104	-	1,410	-	(2,555)	(985)
Exchange difference	-	(1)	-	(6)	-	-	(7)
At 31 December	28,631	11,524	13,393	25,757	1,981	3,403	84,689
Accumulated depreciation							
At 1 January	16,735	9,992	10,519	18,722	961	-	56,929
Charge for the year (Note 32)	3,770	1,968	1,971	3,664	234	-	11,607
Disposals	(4,209)	(6,201)	(3,164)	(4,172)	-	-	(17,746)
Write-off	(282)	-	-	-	-	-	(282)
Exchange difference	-	1	-	(9)	-	-	(8)
At 31 December	16,014	5,760	9,326	18,205	1,195	-	50,500
Net book value							
At 31 December	12,617	5,764	4,067	7,552	786	3,403	34,189
Bank							
2013							
Cost							
At 1 January	29,134	17,173	16,159	27,429	1,321	1,558	92,774
Additions	3,339	225	336	737	660	4,139	9,436
Disposals	(4,189)	(6,172)	(3,182)	(4,117)	-	-	(17,660)
Write-offs	(319)	-	-	-	-	-	(319)
Transfers	57	104	-	1,410	-	(2,294)	(723)
At 31 December	28,022	11,330	13,313	25,459	1,981	3,403	83,508
Accumulated depreciation							
At 1 January	16,416	9,901	10,481	18,524	961	-	56,283
Charge for the year (Note 32)	3,702	1,939	1,956	3,618	234	-	11,449
Disposals	(4,189)	(6,169)	(3,164)	(4,131)	-	-	(17,653)
Write-offs	(319)	-	-	-	-	-	(319)
At 31 December	15,610	5,671	9,273	18,011	1,195	-	49,760
Net book value							
At 31 December	12,412	5,659	4,040	7,448	786	3,403	33,748

The additions for the year in respect of renovation include accrued restoration cost for the Group of RM3,146,101 (2012: RM70,200) and the Bank of RM3,109,101 (2012: RM Nil).

15 PROPERTY AND EQUIPMENT (Cont'd.)

Group 2012	Renovation RM'000	Furniture & fittings RM'000	Office equipment RM'000	Computer equipment hardware RM'000	Motor vehicles RM'000	Work-in-progress RM'000	Total RM'000
Cost							
At 1 January	18,714	11,097	12,614	24,048	1,321	1,487	69,281
Additions	1,500	975	1,928	2,464	-	23,357	30,224
Disposals	-	-	-	-	-	-	-
Write-offs	(575)	-	-	-	-	-	(575)
Transfers	10,125	5,290	1,693	1,273	-	(23,025)	(4,644)
Exchange difference	(2)	(1)	-	(2)	-	-	(5)
At 31 December	29,762	17,361	16,235	27,783	1,321	1,819	94,281
Accumulated depreciation							
At 1 January	13,690	7,856	8,560	14,584	736	-	45,426
Charge for the year (Note 32)	3,622	2,138	1,959	4,140	225	-	12,084
Disposals	-	-	-	-	-	-	-
Write-off	(575)	-	-	-	-	-	(575)
Transfers	-	-	-	-	-	-	-
Exchange difference	(2)	(2)	-	(2)	-	-	(6)
At 31 December	16,735	9,992	10,519	18,722	961	-	56,929
Net book value							
At 31 December	13,027	7,369	5,716	9,061	360	1,819	37,352
Bank							
2012							
Cost							
At 1 January	18,338	11,049	12,569	23,779	1,321	1,487	68,543
Additions	1,209	834	1,897	2,377	-	23,096	29,413
Disposals	-	-	-	-	-	-	-
Write-offs	(538)	-	-	-	-	-	(538)
Transfers	10,125	5,290	1,693	1,273	-	(23,025)	(4,644)
At 31 December	29,134	17,173	16,159	27,429	1,321	1,558	92,774
Accumulated depreciation							
At 1 January	13,419	7,800	8,533	14,431	736	-	44,919
Charge for the year (Note 32)	3,535	2,101	1,948	4,093	225	-	11,902
Write-offs	(538)	-	-	-	-	-	(538)
Transfers	-	-	-	-	-	-	-
At 31 December	16,416	9,901	10,481	18,524	961	-	56,283
Net book value							
At 31 December	12,718	7,272	5,678	8,905	360	1,558	36,491

16 INTANGIBLE ASSETS

	Group		Bank	
	2013 RM'000	2012 RM'000	2013 RM'000	2012 RM'000
Computer software				
Cost				
At 1 January	57,632	50,542	56,778	50,496
Additions	444	2,446	385	1,638
Transfers from property and equipments	985	4,644	723	4,644
Exchange difference	54	-	-	-
At 31 December	59,115	57,632	57,886	56,778
Accumulated amortisation				
At 1 January	35,792	27,120	35,609	27,093
Amortisation for the year (Note 32)	9,043	8,672	8,808	8,516
Exchange difference	16	-	-	-
At 31 December	44,851	35,792	44,417	35,609
Carrying amount				
At 31 December	14,264	21,840	13,469	21,169

17 DEFERRED TAXATION

	Group		Bank	
	2013 RM'000	2012 RM'000	2013 RM'000	2012 RM'000
At 1 January	286,641	293,911	286,538	293,824
Recognised in other comprehensive income	1,663	991	1,663	991
Recognised in profit and loss (Note 35)	(47,046)	(8,261)	(47,067)	(8,277)
At 31 December	241,258	286,641	241,134	286,538
Presented after appropriate offsetting as follows:				
Deferred tax assets (net)	241,258	286,641	241,134	286,538

17 DEFERRED TAXATION (Cont'd.)

The components and movements of deferred tax assets and liabilities during the financial year are as follows:

Deferred tax assets of the Group:	Impairment and allowance on financing RM'000	Unrealised loss/(gain) on securities available-for-sale RM'000	Unused tax losses RM'000	Other temporary differences RM'000	Total RM'000
2013					
At 1 January	-	(234)	288,434	5,106	293,306
Recognised in profit or loss	-	-	(59,466)	10,942	(48,524)
Recognised in other comprehensive income	-	1,663	-	-	1,663
At 31 December	-	1,429	228,968	16,048	246,445
2012					
At 1 January	26,285	(1,225)	260,909	15,207	301,176
Recognised in profit or loss	(26,285)	-	27,525	(10,101)	(8,861)
Recognised in other comprehensive income	-	991	-	-	991
At 31 December	-	(234)	288,434	5,106	293,306
Deferred tax assets of the Bank:					
2013					
At 1 January	-	(234)	288,421	5,016	293,203
Recognised in profit or loss	-	-	(59,523)	10,978	(48,545)
Recognised in other comprehensive income	-	1,663	-	-	1,663
At 31 December	-	1,429	228,898	15,994	246,321
2012					
At 1 January	26,285	(1,225)	260,909	15,120	301,089
Recognised in profit or loss	(26,285)	-	27,512	(10,104)	(8,877)
Recognised in other comprehensive income	-	991	-	-	991
At 31 December	-	(234)	288,421	5,016	293,203

17 DEFERRED TAXATION (Cont'd.)

The components and movements of deferred tax assets and liabilities during the financial year are as follows: (Cont'd.)

Deferred tax liabilities of the Group and Bank:	**Accelerated capital allowances RM'000**	**Total RM'000**
2013		
At 1 January,	6,665	6,665
Recognised in profit or loss	(1,478)	(1,478)
At 31 December	5,187	5,187
2012		
At 1 January,	7,265	7,265
Recognised in profit or loss	(600)	(600)
At 31 December	6,665	6,665

<u>Unutilised tax losses and unabsorbed capital allowance</u>

At the reporting date, the Group and the Bank has recognised deferred tax asset on the following temporary difference:

	Group and Bank	
	2013 RM'000	**2012 RM'000**
Unutilised tax losses	934,629	1,172,721
	934,629	1,172,721

The deferred tax assets have been recognised as at 31 December 2013 as the directors are of the view that it is probable for the Bank to realise the deferred tax asset.

In evaluating the ability to realise the deferred tax assets, the Bank relies principally on forecasted taxable income using historical and projected future operating results and the reversal of existing temporary differences within a five to six years horizon.

17 DEFERRED TAXATION (Cont'd.)

Unutilised tax losses and unabsorbed capital allowance (Cont'd.)

At the reporting date the Group has not recognised the deferred tax asset in respect of the following items:

	Group	
	2013 RM'000	2012 RM'000
Unutilised tax losses	21,793	23,022
Unabsorbed capital allowances	241	254
	22,034	23,276

The unutillised tax losses and unabsorbed capital allowance above are available for offset against future taxable profits of the Bank and the subsidiaries respectively.

The availability of unutilised tax losses and unabsorbed capital allowances of the Group for offsetting against future taxable profits of the companies in which the losses arose, for which no deferred tax assets is recognised due to uncertainty in its recoverbility, are subject to no substantial changes in shareholding of these subsidiaries under the Income Tax Act 1967 and other guidelines issued by the tax authority.

18 DEPOSITS FROM CUSTOMERS

	Group		Bank	
	2013 RM'000	2012 RM'000	2013 RM'000	2012 RM'000
(i) By type of deposit				
Non Mudharabah				
- Demand deposits	561,296	633,640	539,869	640,414
- Gold deposits	158,910	165,051	158,910	165,051
- Wakalah deposits	1,421,572	834,589	1,421,134	834,589
Mudharabah				
- Savings deposits	81,185	47,267	81,185	47,267
- General investment deposits	236,630	234,199	236,630	234,199
- Negotiable Instrument Deposit	165,275	717,284	165,275	717,284
Murabahah	2,717,774	2,738,235	2,717,774	2,738,235
	5,342,642	5,370,265	5,320,777	5,377,039

18 DEPOSITS FROM CUSTOMERS (Cont'd.)

	Group		Bank	
	2013 RM'000	2012 RM'000	2013 RM'000	2012 RM'000
(ii) By type of customer				
Business enterprises	2,493,905	2,000,432	2,450,174	1,995,175
Individuals	1,046,038	830,156	1,046,038	830,156
Subsidiaries	-	-	21,866	12,117
Government and statutory bodies	1,533,534	1,549,745	1,533,534	1,549,745
Others	269,165	989,932	269,165	989,846
	5,342,642	5,370,265	5,320,777	5,377,039
(iii) By contractual maturity				
Due within six months	4,579,884	4,105,097	4,558,019	4,111,871
More than six months to one year	725,216	1,172,362	725,216	1,172,362
More than one year to three years	37,542	92,806	37,542	92,806
	5,342,642	5,370,265	5,320,777	5,377,039

19 DEPOSITS AND PLACEMENTS OF BANKS AND OTHER FINANCIAL INSTITUTIONS

	Group		Bank	
	2013 RM'000	2012 RM'000	2013 RM'000	2012 RM'000
Murabahah				
Licensed Islamic banks	45,870	76,452	45,870	76,452
Other financial institutions	562,970	527,874	562,970	535,485
Wakalah				
Licensed Commercial banks	-	30,609	-	-
Licensed Islamic banks	-	104,277	-	30,109
Licensed investment banks	-	30,590	-	30,590
Other financial institutions	1,162,720	554,674	1,144,897	531,854
	1,771,560	1,324,476	1,753,737	1,204,490

20 OTHER LIABILITIES

	Note	Group 2013 RM'000	Group 2012 RM'000	Bank 2013 RM'000	Bank 2012 RM'000
Sundry creditors	(i)	285,391	185,677	285,366	185,632
Accrued restoration cost		5,681	3,496	5,574	3,313
Provision for tax		-	13	-	-
Other provisions and accruals		38,959	22,871	38,249	22,269
Undistributed charity funds	(ii)	1,259	7,291	1,259	7,291
		331,290	219,348	330,448	218,505

(i) Included in sundry creditors relates to amount payable to holding company of RM184.4 million (2012: RM142.8 million) arising from revenue streams of Specific Profit Sharing Investment

(ii) Sources and uses of charity funds:

	Group and Bank 2013 RM'000	Group and Bank 2012 RM'000
Sources of charity funds:		
Undistributed charity funds as at 1 January	7,291	8,785
Penalty charges on late payment	7,782	2,888
Total sources of funds during the year	15,073	11,673
Uses of charity funds:		
Contribution to Baitulmal	(130)	-
Compensation of late payment charges (Note 27)	(12,643)	-
Contribution to non profit organisations	(722)	(4,092)
Aid to needy family	(319)	(290)
Total uses of funds during the year	(13,814)	(4,382)
Undistributed charity funds as at 31 December	1,259	7,291

21 PROVISION FOR ZAKAT

In 2013, Zakat is calculated based on opening reserve method of Kuwait Finance House (Malaysia) and paid by Kuwait Finance House K.S.C who is the main shareholder of the Bank.

22 SUBORDINATED MURABAHAH TAWARRUQ

The principal of subordinated Murabahah Tawarruq is a facility agreement with the holding company of the Bank, Kuwait Finance House K.S.C. The facility with principal and profit amount of USD126,864,726 or equivalent RM415,577,127 (2012: USD122,319,817 or equivalent RM374,054,000) is unsecured with a tenure of five years and forms part of the Bank's Tier-2 capital. The Murabahah profit is determined with reference to London Interbank Offer Rate ("LIBOR").

23 SHARE CAPITAL

	Number of ordinary shares at RM1.00 each		Amount	
	2013 Units'000	2012 Units'000	2013 RM'000	2012 RM'000
Authorised:				
At 1 January/At 31 December	3,000,000	3,000,000	3,000,000	3,000,000
Issued and fully paid:				
At 1 January	2,266,125	2,266,125	2,266,125	2,266,125
Effect of capital reduction	(840,853)	-	(840,853)	-
At 1 January/At 31 December	1,425,272	2,266,125	1,425,272	2,266,125

During the financial year 2013, the Bank decreased its issued and paid up share capital from RM2,266,125,000 to RM1,425,272,000 in March 2013 pursuant to the capital reduction exercise. KFHMB's share capital of RM2,266,125,000 consisting of RM2,266,125,000 ordinary shares of RM1.00 each has been reduced by the cancellation of RM840,853,000 issued and fully paid up shares of the Bank of RM1.00 each.

24 RESERVES

		Group		Bank	
	Note	2013 RM'000	2012 RM'000	2013 RM'000	2012 RM'000
Non-distributable					
Statutory reserve	(i)	113,895	66,697	113,895	66,697
Exchange fluctuation reserve	(ii)	(5,088)	(7,112)	-	-
Available-for-sale reserve	(iii)	(26,871)	2,574	(26,142)	355
		81,936	62,159	87,753	67,052
Distributable					
Retained earning/ (accumulated losses)	(iv)	82,406	(808,989)	62,372	(825,678)
		164,342	(746,830)	150,125	(758,626)

24 RESERVES (Cont'd.)

The nature and purpose of each category of reserve are as follows:

(i) Statutory reserve

The statutory reserve is maintained in compliance with Capital Funds for Islamic Banks issued on 1 July 2013 and is not distributable as cash dividends.

(ii) Exchange fluctuation reserve

This reserve comprises all foreign exchange differences arising from the translation of the financial statements of subsidiaries.

(iii) Available-for-sale reserve

This reserve represents the difference between fair value of the securities and their costs determined as at the statements of financial position date, excluding the amount relating to impaired securities.

Movements of the available-for-sale reserve are as follows:

	Group		Bank	
	2013 RM'000	2012 RM'000	2013 RM'000	2012 RM'000
At 1 January	2,574	(3,307)	355	(4,105)
Net unrealised (losses)/gain on securities available-for-sale financial investments	(29,634)	10,345	(26,624)	9,143
Net realised gain/(losses) on securities available-for-sale financial investments reclassified to the income statement	189	(4,464)	127	(4,683)
At 31 December	(26,871)	2,574	(26,142)	355

(iv) Retained earning/(accumulated losses)

Prior to the year of assessment 2008, Malaysian companies adopted the full imputation system. In accordance with the Finance Act 2007 which was gazetted on 28 December 2007, companies shall not be entitled to deduct tax on dividends paid, credited or distributed to its shareholders, and such dividends will be exempted from tax in the hands of the shareholders ("single tier system"). However, there is a transitional period of six years, expiring on 31 December 2013, to allow companies to pay franked dividends to their shareholders under limited circumstances. Companies also have an irrevocable option to disregard the 108 balance and opt to pay dividends under the single tier system. The change in the tax legislation also provides for the 108 balance to be locked-in as at 31 December 2007 in accordance with Section 39 of the Finance Act 2007.

The Bank did not elect for the irrevocable option to disregard the 108 balance. Accordingly, during the transitional period, the Bank may utilise the credit in the 108 balance to distribute cash dividend payments to ordinary shareholders as defined under the Finance Act 2007. As at 31 December 2013, the 108 balance of the Bank is RM15,158,856 (2012: RM15,158,856). Any 108 balance which has not been utilised as at 31 December 2013 is disregarded. The balance of the retained earning as at 31 December 2013 may be distributed as dividends under the single tier system.

25 OPERATING REVENUE

Operating revenue of the Group comprises all types of revenue derived from the business of banking but excluding all transactions between related companies.

Operating revenue of the Bank comprises financing income, fee and commission income, investment income, trading income, gross dividends and other income derived from banking operations.

26 INCOME DERIVED FROM INVESTMENT OF DEPOSITORS' FUNDS AND OTHERS

	Group		Bank	
	2013 RM'000	**2012 RM'000**	**2013 RM'000**	**2012 RM'000**
Income derived from investment of :				
(i) General investment deposits	11,148	13,718	11,114	14,563
(ii) Other deposits	328,860	370,123	326,869	362,644
	340,008	383,841	337,983	377,207
(i) Income derived from investment of general investment deposits				
Finance income from financing, advances and other receivables	8,708	9,730	8,736	10,439
Finance income from impaired financing	248	540	248	574
Securities				
- Held-for-trading	18	80	18	84
- Available-for-sale	953	1,099	894	1,078
- Held-to-maturity	113	61	113	65
Money-at-call and deposits with financial institutions	1,115	1,270	1,111	1,314
	11,155	12,780	11,120	13,554
Amortisation of premium less accretion of discount	(122)	(146)	(122)	(154)
Total finance income and hibah	11,033	12,634	10,998	13,400
Gain arising from sale of securities				
- Held-for-trading	38	108	38	121
- Available-for-sale	31	601	31	641
Foreign exchange gain - realised	335	335	336	358
(Loss)/ gain on Ijarah rental swap obligations	(289)	40	(289)	43
	11,148	13,718	11,114	14,563

26 INCOME DERIVED FROM INVESTMENT OF DEPOSITORS' FUNDS AND OTHERS (Cont'd.)

	Group		Bank	
	2013 RM'000	**2012 RM'000**	**2013 RM'000**	**2012 RM'000**
(ii) Income derived from investment of other deposits				
Finance income from financing, advances and other receivables	256,772	261,532	256,810	257,364
Finance income from impaired financing	7,417	13,699	7,422	13,494
Securities				
- Held-for-trading	524	2,119	524	2,090
- Available-for-sale	28,160	30,639	26,321	28,323
- Held-to-maturity	3,323	1,534	3,324	1,507
Money-at-call and deposits with financial institutions	33,072	35,384	32,886	35,438
	329,268	344,907	327,287	338,216
Amortisation of premium less accretion of discount	(3,605)	(4,123)	(3,605)	(4,080)
Total finance income and hibah	325,663	340,784	323,682	334,136
Gain arising from sale of securities				
- Held-for-trading	1,118	2,788	1,118	2,730
- Available-for-sale	927	16,406	927	15,783
Foreign exchange gain - realised	9,798	9,053	9,798	8,920
(Loss)/ gain on Ijarah rental swap obligations	(8,646)	1,092	(8,656)	1,075
	328,860	370,123	326,869	362,644

NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2013

27 INCOME DERIVED FROM INVESTMENT OF SHAREHOLDER'S EQUITY

	Group		Bank	
	2013 RM'000	2012 RM'000	2013 RM'000	2012 RM'000
Finance income from financing, advances and other receivables	59,718	53,053	59,653	56,513
Finance income from impaired financing	1,700	2,986	1,695	3,157
Securities				
- Held-for-trading	120	434	119	458
- Available-for-sale	6,538	5,977	6,104	5,813
- Held-to-maturity	772	334	771	356
Money-at-call and deposits with financial institutions	7,644	6,867	7,589	7,058
	76,492	69,651	75,931	73,355
Amortisation of premium less accretion of discount	(838)	(796)	(837)	(832)
Total finance income and hibah	75,654	68,855	75,094	72,523
Fee income				
- Commissions	3,849	2,877	3,852	2,882
- Fund management fee	2,846	3,349	-	-
- Other fee income	19,080	18,288	18,941	18,282
- Compensation of late payment charges	12,643	-	12,643	-
Gain arising from sale of securities				
- Held-for-trading	254	589	253	657
- Available-for-sale	208	3,302	207	3,491
Unrealised gain on revaluation of securities held-for-trading and Ijarah rental swap (net)	10,217	33,902	10,217	33,902
Foreign exchange gain/ (loss)				
- Realised	2,941	(2,824)	2,941	(2,713)
- Unrealised	(3,649)	(19,404)	(3,789)	(19,409)
(Loss)/ gain on Ijarah rental swap obligations	(1,965)	220	(1,955)	235
Gross dividend from property funds (securities available-for-sale)	1,250	1,178	-	-
Gain on disposal of property and equipment	367	-	384	-
Gain on Ijarah Automobile	24	-	24	-
Other income	272	232	-	-
Gross dividend from subsidiary	-	-	6,601	-
Management fee	-	-	(1,282)	(1,362)
	123,991	110,564	124,131	108,488

28 IMPAIRMENT (WRITE BACK)/ ALLOWANCES ON FINANCING, ADVANCES AND OTHER RECEIVABLES

	Group		Bank	
	2013 RM'000	2012 RM'000	2013 RM'000	2012 RM'000
Allowances for (Note 9(xii)):				
- Collective assessment	52,326	(2,266)	52,326	(2,266)
- Individual assessment:	(116,236)	(2,041)	(116,236)	(2,041)
Allowances charged during the period	85,308	134,599	85,308	134,599
Allowances written-back during the period	(201,544)	(131,045)	(201,544)	(131,045)
Reversal of allowances on previously written off financing	-	(5,595)	-	(5,595)
Bad debt recovered on financing	(44,172)	(10,157)	(44,172)	(10,157)
	(108,082)	(14,464)	(108,082)	(14,464)

29 IMPAIRMENT LOSS AND ALLOWANCES ON INVESTMENTS

	Group		Bank	
	2013 RM'000	2012 RM'000	2013 RM'000	2012 RM'000
Securities available-for-sale	1,299	4,949	1,299	1,507
Investment in subsidiaries	-	-	11,520	-
Other impairment loss	2,100	-	2,100	-
	3,399	4,949	14,919	1,507

30 INCOME ATTRIBUTABLE TO DEPOSITORS

	Group		Bank	
	2013 RM'000	2012 RM'000	2013 RM'000	2012 RM'000
Deposits from customers				
- Mudharabah	8,306	9,540	8,306	9,540
- Non Mudharabah	88,669	79,587	88,669	79,587
- Wakalah	32,873	11,311	32,283	11,311
- Negotiable Instrument Deposit	23,225	23,229	23,225	23,229
Deposits and placements of banks and other financial institutions				
- Murabahah and wakalah	28,065	69,666	28,520	69,479
- Others	242	263	242	263
	181,380	193,596	181,245	193,409

31 PERSONNEL EXPENSES

	Group		Bank	
	2013 RM'000	**2012 RM'000**	**2013 RM'000**	**2012 RM'000**
Salaries and wages	61,911	62,242	57,848	59,170
Social security costs	386	414	379	407
Pension costs - defined contribution plan	12,408	12,172	11,699	11,738
Other staff related costs	43,328	26,524	42,622	26,438
	118,033	101,352	112,548	97,753

Included in personnel expenses of the Group and the Bank during the financial year are the remuneration attributable to the Chief Executive Officer of the Bank, including benefits-in-kind amounting to RM4,134,672 (2012: RM2,743,022).

32 OTHER OVERHEADS AND EXPENDITURES

	Group		Bank	
	2013 RM'000	**2012 RM'000**	**2013 RM'000**	**2012 RM'000**
Promotion				
Advertisement and publicity	5,218	9,687	5,217	9,661
Establishment				
Rental	20,776	17,383	19,831	16,297
Depreciation of property and equipment (Note 15)	11,607	12,084	11,449	11,902
Amortisation of intangible assets (Note 16)	9,043	8,672	8,808	8,516
IT expenses	8,243	7,528	8,240	7,512
Hire of equipment	944	1,144	904	1,067
	55,831	56,498	54,449	54,955

NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2013

32 OTHER OVERHEADS AND EXPENDITURES (Cont'd.)

	Group 2013 RM'000	Group 2012 RM'000	Bank 2013 RM'000	Bank 2012 RM'000
General expenses				
Auditors remuneration				
- Statutory audit:	409	391	283	259
- Ernst & Young Malaysia	321	295	283	259
- Other member firms of Ernst & Young Global	88	96	-	-
- Non-audit services:	188	195	188	195
- Review engagements and regulatory-related services	188	150	188	150
- Other services	-	45	-	45
Professional fees	4,197	6,479	3,993	6,080
Non executive directors' remuneration (Note 34)	2,412	2,375	2,067	2,018
Shariah Committee's remuneration (Note 34)	775	741	775	741
Murabahah agent fees	401	809	401	809
Subscription fees	3,304	5,270	3,177	5,166
Communication expenses	4,077	3,956	3,983	3,851
Other fees	16,351	11,885	16,351	11,885
Others	18,351	16,428	16,199	14,639
	50,465	48,529	47,417	45,643
Total overheads and expenditures	106,296	105,027	101,866	100,598

33 FINANCE COST

	Group 2013 RM'000	Group 2012 RM'000	Bank 2013 RM'000	Bank 2012 RM'000
Subordinated Murabahah Tawarruq	14,395	13,551	14,395	13,551
	14,395	13,551	14,395	13,551

34 DIRECTORS' AND SHARIAH COMMITTEE'S REMUNERATION

	Group 2013 RM'000	Group 2012 RM'000	Bank 2013 RM'000	Bank 2012 RM'000
Non-Executive Directors				
Directors of the Bank				
Fees	1,355	1,354	1,355	1,354
Other remuneration	712	664	712	664
	2,067	2,018	2,067	2,018

34 DIRECTORS' AND SHARIAH COMMITTEE'S REMUNERATION (Cont'd.)

	Group		Bank	
	2013 RM'000	**2012 RM'000**	**2013 RM'000**	**2012 RM'000**
Directors of subsidiary company				
Fees	334	336	-	-
Other remuneration	11	21	-	-
	345	357	-	-
Total Non-Executive Directors	2,412	2,375	2,067	2,018
Shariah Committee				
Fees	504	504	504	504
Other remuneration	271	237	271	237
	775	741	775	741

The number of directors of the Bank whose total remuneration during the financial year fell within the following bands is analysed below:

	Bank	
	Number of directors	
	2013	**2012**
Non-Executive Directors		
RM1,000 - RM100,000	1	2
RM100,001 - RM150,000	-	1
RM150,001 - RM200,000	1	2
RM200,001 - RM250,000	1	-
RM250,001 - RM300,000	2	2
RM300,001 - RM400,000	3	3
Total	8	10

35 TAXATION

	Group		Bank	
	2013 RM'000	**2012 RM'000**	**2013 RM'000**	**2012 RM'000**
Malaysian income tax				
- Current year	87	65	-	-
- Under provision of income tax in prior year	3,705	21,574	3,761	21,574
Deferred tax (Note 17):				
- Relating to origination and reversal of temporary differences	38,238	24,567	38,259	24,568
- Derecognition/ (recognition) of deferred tax not recognised in prior years	8,808	(16,306)	8,808	(16,291)
	50,838	29,900	50,828	29,851

Domestic current income tax is calculated at the Malaysian statutory tax rate of 25% (2012: 25%) of the estimated assessable profit for the year. The computation of deferred tax as at 31 December 2013 have reflected these changes.

Taxation for other jurisdictions are calculated at the rates prevailing in the respective jurisdictions.

A reconciliation of income tax expense applicable to profit before taxation at the statutory income tax rate to income tax expense at the effective income tax rate of the Group and of the Bank are as follows:

	Group		Bank	
	2013 RM'000	**2012 RM'000**	**2013 RM'000**	**2012 RM'000**
Profit before taxation	148,578	90,394	145,223	93,341
Taxation at Malaysian statutory tax rate of 25% (2012: 25%)	37,145	22,599	36,306	23,335
Expenses not deductible for tax purposes	1,031	1,439	1,953	1,233
Deferred tax assets not recognised on unutilised tax losses and unabsorbed capital allowances	149	594	-	-
Derecognition/ (recognition) of deferred tax not recognised in prior years	8,808	(16,306)	8,808	(16,291)
Under provision of tax expense in prior year	3,705	21,574	3,761	21,574
Tax expense for the year	50,838	29,900	50,828	29,851

36 EARNINGS PER SHARE

Basic and diluted earnings per share of the Group is calculated by dividing the net profit for the financial year by the weighted average number of ordinary shares in issue during the financial year.

	Group	
	2013	**2012**
Net profit for the year (RM'000)	97,740	60,494
Weighted average number of ordinary shares in issue ('000) *	1,425,272	1,425,272
Basic/ diluted earnings per share (sen)	6.86	4.24

* As the capital reduction exercise completed during the year did not result to a corresponding change in resources of the Bank, for the purposes of calculating the earnings per share, the weighted average number of ordinary shares in issue has been retrospectively adjusted.

37 RELATED PARTY TRANSACTIONS

The Directors are of the opinion that all transactions below have been entered into in the normal course of business and have been established on terms and conditions that are not materially different from those obtained in transactions with unrelated parties.

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions, or if one other party controls both.

The related parties of the Group and the Bank are as follows:

Holding Company
Details of holding company are disclosed in Note 45.

Subsidiaries
Details of subsidiaries are disclosed in Note 14.

Subsidiaries of holding company
Subsidiaries of the holding company are KFH (Bahrain) B.S.C., Saudi Kuwaiti Finance House S.S.C., Liquidity Management House K.S.C.C., KFH Research Limited, International Turnkey System, Kuveyt Turk Participation K.S.C. and KFH Global Sukuk Fund.

Key management personnel
Key management personnel are defined as those persons having authority and responsibility for planning, directing and controlling the activities of the Group and the Bank either directly or indirectly. The key management personnel of the Group and the Bank includes selected Heads of Divisions.

Directors
The identity of the directors of the Bank, are disclosed in the Director's report.

37 RELATED PARTY TRANSACTIONS (Cont'd.)

(a) Related party transactions

The significant transactions and outstanding balances of the Bank with its related parties are as follows:

2013	Holding company RM'000	Subsidiaries RM'000	Subsidiaries of holding companies RM'000	Key management personnel RM'000	Companies with common directors RM'000	Directors RM'000
(i) Income						
- Management fees	-	706	-	-	-	-
- Profit income on placements	-	21	2,235	-	-	-
- Profit income on financing	-	-	-	52	17,922	-
	-	727	2,235	52	17,922	-
(ii) Expenditure						
- Profit expense on deposits	238	816	1,067	173	-	2
- Other fees	-	1,988	2,357	-	-	-
- Profit expense on Subordinated Murabahah Tawarruq	14,395	-	-	-	-	-
	14,633	2,804	3,424	173	-	2

37 RELATED PARTY TRANSACTIONS (Cont'd.)

(a) Related party transactions

The significant transactions and outstanding balances of the Bank with its related parties are as follows:

2013 (Cont'd.)	Holding company RM'000	Subsidiaries RM'000	Subsidiaries of holding companies RM'000	Key management personnel RM'000	Companies with common directors RM'000	Directors RM'000
(iii) Amount due to related parties						
- Subordinated Murabahah Tawarruq	415,577	-	-	-	-	-
- Deposits from customers	-	16,895	65,673	5,846	4,985	309
- Deposits and placements of banks and other FIs	-	227,857	278,441	-	-	-
- Sundry creditors (Note 20)	184,429	-	-	-	-	-
	600,006	244,752	344,114	5,846	4,985	309
(iv) Amount due from related parties						
- Securities	-	-	153,215	-	-	-
- Financing	-	-	-	2,164	353,875	-
- Deposits and placements with banks and other FIs	-	26,836	-	-	-	-
- Other assets	298	4	615	-	-	-
	298	26,841	153,830	2,164	353,875	-
(v) Others						
- Purchases of intangible assets	-	-	1,508	-	-	-
	-	-	1,508	-	-	-

37 RELATED PARTY TRANSACTIONS (Cont'd.)

(a) Related party transactions (Cont'd.)

2012	Holding company RM'000	Subsidiaries RM'000	Subsidiaries of holding companies RM'000	Key management personnel RM'000	Companies with common directors RM'000	Directors RM'000
(i) Income						
- Management fees	-	780	-	-	-	-
- Profit income on placements	2	396	6,129	-	-	-
- Profit income on financing	-	-	-	59	33,720	-
	2	1,176	6,129	59	33,720	-
(ii) Expenditure						
- Profit expense on deposits	24,897	382	3,759	5	45	5
- Other fees	-	2,142	2,950	-	-	-
- Profit expense on Subordinated Murabahah Tawarruq	13,396	-	-	-	-	-
	38,293	2,524	6,709	5	45	5

37 RELATED PARTY TRANSACTIONS (Cont'd.)

(a) Related party transactions (Cont'd.)

	Holding company RM'000	Subsidiaries RM'000	Subsidiaries of holding companies RM'000	Key management personnel RM'000	Companies with common directors RM'000	Directors RM'000
2012 (Cont'd.)						
(iii) Amount due to related parties						
- Subordinated Murabahah Tawarruq	374,054	-	-	-	-	-
- Deposits from customers	-	12,117	195,737	5,830	-	1,197
- Deposits and placements of banks and other FIs	9,250	86,178	-	-	-	-
- Sundry creditors (Note 20)	142,771	-	-	-	-	-
	526,075	98,295	195,737	5,830	-	1,197
(iv) Amount due from related parties						
- Securities	-	-	15,290	-	-	-
- Financing	-	-	-	2,622	515,295	-
- Deposits and placements with banks and other FIs	-	-	152,900	-	-	-
- Other assets	294	425	1,615	-	-	-
	294	425	169,805	2,622	515,295	-
(v) Others						
- Purchases of intangible assets	-	-	3,395	-	-	-
	-	-	3,395	-	-	-

37 RELATED PARTY TRANSACTIONS (Cont'd.)

(b) Key management personnel compensation

The remuneration of key management personnel during the year are as follows:

	Group		Bank	
	2013 RM'000	**2012 RM'000**	**2013 RM'000**	**2012 RM'000**
Short-term employee benefits				
- Salary and other remuneration	19,387	11,017	17,167	10,170
- Benefits-in-kind	60	-	35	-
	19,447	11,017	17,202	10,170

The total key management personnel compensation includes Chief Executive Officer remuneration of which details are disclosed in Note 31 and Note 34.

(c) Credit transactions and exposures with connected parties

	2013			
	Total outstanding value RM'000	**Total number of accounts**	**Total exposure * RM'000**	**Total non-performing credit exposure RM'000**
Financing, credit facility and leasing (except guarantee)	354,786	4	354,786	-
	354,786	4	354,786	-
Total exposure to connected parties as % capital base			22.6%	0.0%
Total exposure to connected parties as % of total outstanding credit exposures			4.5%	0.0%

37 RELATED PARTY TRANSACTIONS (Cont'd.)

(c) Credit transactions and exposures with connected parties (Cont'd.)

	2012			
	Total outstanding value RM'000	**Total number of accounts**	**Total exposure * RM'000**	**Total non-performing credit exposure RM'000**
Financing, credit facility and leasing (except guarantee)	516,410	6	513,221	-
Equities and Islamic Private Debt Securities held	15,290	1	15,290	-
Off-balance sheet exposures	-	2	1,258	-
	531,700	9	529,769	-
Total exposure to connected parties as % capital base			35.4%	0.0%
Total exposure to connected parties as % of total outstanding credit exposures			7.1%	0.0%

* Included total outstanding and unutilised limit.

The credit exposure above are derived based on para 9.1 of Bank Negara Malaysia's revised Guidelines on Credit Transaction and Exposures with Connected Parties.

Based on these guidelines, a connected party refers to the following:

(i) Directors of the Bank and their close relatives;

(ii) Controlling shareholder and his close relatives;

(iii) Executive officer, being a member of management having authority and responsibility of planning, directing and/or controlling the activities of the Bank, and his close relatives;

(iv) Officers who are responsible for or have the authority to appraise and/or approve credit transactions or review the status of existing credit transactions, either as a member of a committee or individually, and their close relatives;

(v) Firms, partnerships, companies or any legal entities which control, or are controlled by any person listed in (i) to (iv) above, or in which they have an interest, as a director, partner, executive officer, agent or guarantor, and their subsidiaries or entities controlled by them;

(vi) Any person for whom the persons listed in (i) to (iv) above is a guarantor; and

(vii) Subsidiary of or an entity controlled by the Bank and its connected parties.

Credit transactions and exposures to connected parties as disclosed above includes the extension of credit facilities and/or off-balance sheet credit exposures such as guarantees, trade-related facilities and financing commitments.

38 COMMITMENTS AND CONTINGENCIES

In the normal course of business, the Bank and its subsidiaries make various commitments and incur certain contingent liabilities with legal recourse to their customers. No material losses are anticipated as a result of these transactions.

	2013			2012		
	Principal amount RM'000	Credit equivalent amount RM'000	Risk weighted amount RM'000	Principal amount RM'000	Credit equivalent amount RM'000	Risk weighted amount RM'000
Group and Bank						
Direct credit substitutes	11,220	11,220	8,889	448,398	448,398	297,589
Transaction related contingencies	142,880	71,440	42,219	130,067	65,032	46,302
Trade related contingencies	23,897	4,779	4,779	28,653	5,731	5,687
Irrevocable commitments to extend credit						
- maturity less than one year	333,208	66,643	65,496	372,828	74,566	70,448
- maturity more than one year	397,811	198,905	197,595	861,949	430,975	416,934
Profit rate related contracts (Ijarah rental swap obligation) *						
- five years and above	263,825	25,585	21,359	278,339	35,216	29,649
	1,172,841	378,572	340,337	2,120,234	1,059,918	866,609
		Note 40 (d)	Note 40 (d)		Note 40 (d)	Note 40 (d)

* The foreign exchange related contracts and Ijarah rental swap related contracts are subject to market risk and credit risk.

38 COMMITMENTS AND CONTINGENCIES (Cont'd.)

The credit equivalent and risk-weighted amounts are computed in accordance with Bank Negara Malaysia's Capital Adequacy Framework for Islamic Banks ("CAFIB").

Market risk

Market risk is the potential change in value caused by movement in market rates or prices. The contractual amounts stated above provide only a measure of involvement in these types of transactions and do not represent the amounts subject to market risk.

Credit risk

Credit risk is the risk that a counterparty will be unable to meet the terms of a contract in which the Bank has a gain position. As at 31 December 2013, the amount of credit risk in the Group and in the Bank, measured in terms of the cost to replace the profitable contracts, was RM15,191,896 (2012: RM21,469,808). This amount will increase or decrease over the life of the contracts, mainly as a function of maturity dates and market rates or prices.